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Introducing Corporate Planning

by

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SECOND EDITION

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FOREWORD TO THE FIRST EDITION

I am not a professional at writing forewords to books. Querying whether I should write one at all, I sat down with two sheets of paper at my side on which I could write short quotations. One was headed "Agree"–the other headed "Disagree".

After a little while I found a third sheet was needed–the "Agree" page was full . . . but to my surprise the "Disagree" page had only one entry!

It is therefore with very great pleasure that I can truly recommend this book to a wide audience.

It has been written by a man "who dun it"! David Hussey is well qualified to write this book as he has personally been closely involved in the long-range corporate planning of three companies in the United Kingdom. As L.R.P. or corporate planning is such a relatively new infant in the management scene in the U.K., this means he was one of the first to introduce it into a company in this country.

I liked this book because it has a realistic approach to the subject. His introduction points out that he is anxious to lay particular emphasis on corporate appraisals, the use of assumptions and the practical systems of making plans work. How much I cheered at this point, for the difficulties which corporate planning sometimes runs into spring from mistakes in one of these areas.

A company fails to appreciate the inherent danger of inadequate investment in labour-saving machinery or research and development, nor realises the export potential it currently has for one of its products.

Great expertise is spent on complex sophisticated forecast models, operational research is widely used, and no one stops to question the underlying assumptions on which the whole of the mathematics is based.

How encouraging to see a planner address himself to the practical problems of getting the plan actually implicated. How vital this is, because the plan in itself does not produce increased profits but the action which

springs from it. For in David Hussey's own words, there is only one justification for corporate planning: "a belief that it can increase profits".

This is therefore no theoretical thesis; this is treating the subject with balance so that the objections to introducing corporate planning are aired and we quickly learn just where plans can go wrong. When one sees the way British firms have in some cases rushed into corporate planning, it is well to study what should be avoided as well as what should be done.

If British industry is to make her way in the seventies, it must be aware of the great dangers that lie ahead and take action. However, inadequate management can swing to the other extreme and not appreciate some of the inherent strengths that British industry has got, particularly when compared to the rest of Europe. It is therefore vital to stimulate the use of professional corporate planning in this country, for only in this way can the resources of industry of the country be properly utilised and economic growth be firmly based.

H. F. R. Perrin
Chairman of the Society for
Long Range Planning
(1967-1970)

ACKNOWLEDGEMENTS

Chapter 4 of this book is based on an article "The Corporate Appraisal" which I wrote for the December 1968 edition of the journal *Long Range Planning*. I thank the publisher for allowing me to use this material.

My especial thanks are due to Professor Bernard Taylor for the help and encouragement I received from him during the preparation of the manuscript.

I should also like to thank those authors and their publishers who have enriched this book by allowing me to quote from their works.

Individual credits appear on the appropriate pages.

Thanks are also due to John Robertson and the Shell Chemical Co. Ltd. for his help and his permission to use certain material on the Directional Policy Matrix (Chapter 8).

INTRODUCTION TO THE SECOND EDITION

In the nine years since I wrote the first edition of this book there have been many developments in the field of corporate planning.

What has happened? Firstly, there has been a considerable growth, world-wide, in corporate planning in private and public sectors. It is now difficult to find a significant organisation which does not give some attention to this important element of the management task. Disappointingly, the growth in the quantity of corporate planning has not always been matched by an overall increase in quality. It is easy to find "planning" organisations, but much more difficult to find ones which are really getting the most out of their planning efforts.

Empirical knowledge of planning is now supported by a significant body of research into how organisations plan, what they get out of it, and why there are failures and successes. The benefits of good planning have been demonstrated by careful research: as have many of the pitfalls that lead to bad planning. For me the strongest emphasis that comes out of the research is the need to give equal attention to careful analysis *and* the behavioural issues around planning. Internal political issues loom very large, since planning may not only change the power and influence structure of the organisation, but may also be seen as a threat by the inadequate. Most planning failures come to grief over these human behavioural issues. They are much harder to correct than a faulty analysis. So a message which I would emphasize, which did appear in the first edition but which has now been strengthened, is to treat the "people" issues in planning with great thought.

The nine years has also seen improvements in planning analysis techniques. Computerised corporate models, which were available at the time, have become very widespread in use. A plethora of software is now commercially available, and it is possible to learn a great deal from the experience of others. Portfolio analysis is becoming well established, although it is still probably a minority technique, bringing with it the concept of analysing a business into

strategic business areas of varying degrees of desirability. These developments have resulted in a completely new chapter: a chapter which should help diversified companies to improve their use of corporate planning.

We have also learnt a great deal about the relationships of the organisation with the business environment. For the next decade at least, the technological changes, seen as most important in early corporate-planning literature, will take second place in their impact on corporate strategy to social and economic factors. To reflect this I have expanded the section of the book which deals with the environment.

The aims and objectives of this book remain unchanged. It is to provide a clear, understandable introduction to the subject which will help any one involved in it. Those who wish to probe deeper into any aspect are referred to the reading list, which has been expanded.

May 1978

D. E. Hussey

INTRODUCTION TO THE FIRST EDITION

There can be few developments in the science of management which have excited the business world more than corporate long-range planning. Virtually unknown in the U.K. five years ago, it has burst like a rocket over the management scene, infecting many with enthusiasm and creating a new type of manager—the professional corporate planner. Seminars on corporate planning are the order of the day, and many articles and a number of books have been published about it.

The rapid development of interest in corporate planning is reflected in the growth of the Society for Long Range Planning, which in its first 2 years of existence reached a membership of nearly 1000 people.

Most of the books and many of the articles have originated in the U.S.A., where the formal planning approach to business has been practised a little longer, but with equal enthusiasm. Like all sound management practices, corporate planning is now international in character. The Society for Long Range Planning has a number of members outside the U.K., and its official journal ***Long Range Planning*** is international both in its editorial concepts and its actual circulation.

Despite the enthusiasm with which many chief executives have turned to planning, and despite the keenness and ability of their planners, it is apparent that many companies face complex problems in converting to a system of management based on the corporate-planning approach.

I know from personal involvement in seminars on planning, from informal meetings with senior managers and practising planners, and from the letters and telephone calls requesting help which I have received from time to time, that the same difficulties are frequently met by numerous companies.

In this book I have tried to provide chief executives, senior managers and planners with an answer to some of these problems. I believe that it will be of particular help to the chief executive contemplating the introduction of corporate planning, and that it will be of value to those line managers who are

caught up in a corporate-planning process, or who take a general interest in the development of the science of management. It is also designed to serve as an introduction to planning for practising planners.

No one book, however great the ambitions of the author, can do justice to the subject of corporate planning, and I hope that those finding the subject interesting will be encouraged to read some of the other books listed in the bibliography. In fact I would recommend the newly appointed planner to this course, since he may require a more detailed knowledge on certain aspects of planning than I have been able to give.

As far as possible the use of technical or pseudo-technical jargon has been avoided. An attempt has been made to roll back the clouds of mystery which many managers still see round the subject of corporate planning. I have positioned planning as a profit-making exercise, rather than something with an "airy-fairy" approach. At the same time I have not conducted an exercise in persuasion. I believe that no chief executive should be bludgeoned into installing a system of corporate planning, and that before he decides that planning is the thing for him he must be fully aware of the implications of his decision on him personally and on his management team. Failure here carries the seeds of destruction, and is behind the disappointment that has accompanied the introduction of planning in some companies. This book provides a guide to the chief executive so that he can assess the situation before reaching a decision.

One of the basic questions frequently asked is "How do we begin corporate planning?" The book provides a management guide to the introduction of planning, based on personal experience.

It also seeks to guide those who ask the question "How do we obtain the co-operation and participation of line management in corporate planning?" This problem has often been raised as a real cry from the heart by planners. It is the fundamental basis for a good system of corporate planning and appears as a recurring theme in virtually every area of planning discussed in the book. The solutions given are based on practical experience.

Many have voiced complaints that the books they have read do not give them a system which they can apply in their own companies. This, of course, is an unrealistic wish for there can be no such thing as a universal system of planning that can be lifted out of the textbook and installed without modification as an aspect of industrial life. This book shows how a system of planning can be devised, and it has been written with the real-life problems of planners very much in mind. The methods described will in principle suit all

companies, and the detailed systems, based on those actually in use in several companies, may fit the needs of many businesses with little adaptation.

Perhaps the most fundamental issue the book tries to tackle is the identification of a basic philosophy behind a good system of corporate planning. Too many companies have entered into formal planning too hastily and too lightly, and many have not recognised that there are principles on which they should be working. While management philosophy will vary to some extent between individuals, I have found many managers blissfully unaware that there is a philosophy behind the corporate-planning approach. The book seeks to help the reader to arrive at his own conclusions through an exploration of the underlying principles.

The setting of objectives is a key stage in the planning process and has a bearing on many other aspects of formal planning. It is an area which continues to worry many people, although it must be mastered if good planning is to result.

I have chosen three often neglected areas for special emphasis. The first is the corporate appraisal, the need for which is often stressed in planning literature but guidance on how to do it rarely given. This, to my mind, is the most important stage in preparing a strategic plan, yet it is the one step which most planners ignore.

The second is the use of assumptions in planning. I believe that these have great value in the assessment and reduction of risk, and that their use in this way is not as widely known as it should be.

The third is a practical system of making plans work. As we all know, the conversion of that beautifully written document into actual action may become a very difficult problem. Yet, unless specific steps are built into the planning process, there will be little hope of making long-range planning a vital part of corporate life. This key chapter will provide a measure of help which I believe to be very much needed.

I have enjoyed the self-imposed task of writing this book, particularly as almost the whole work fitted in with what would otherwise have been wasted time on my daily return train journey from London to Horsham. The justification for publishing a book is not the personal enjoyment of the author (however dull the train journey might otherwise have become!). To be worth while, it must add a small contribution to the improvement and development of its chosen subject.

I hope that my readers will feel that I have passed this test: if not, I am sure that my fellow corporate planners will soon tell me.

I should like to acknowledge the great contribution made to this book by the ladies who converted my handwritten manuscripts into something the publisher could read. It is with gratitude that I thank Mrs. H. C. Bratherton for so cheerfully undertaking the task of typing the bulk of the manuscript, and Miss V. Dauris for her assistance in the final stages which enabled me to meet my deadlines.

D. E. Hussey

CHAPTER 1

THE CORPORATE PLANNING PROCESS AND THE NEED FOR PLANNING

The future is a problem for every business. All responsible managers see the continued existence of their organisation as a prime management task. None of us can really know what the future holds: however good our forecasts, however carefully we lay our plans, there still remain the thousand and one things which we are unable to predict. Yet if we did know everything how dull life would be.

There cannot be a single chief executive who has devoted no time to thinking about where his company is going and what it will be doing in the years ahead. Yet there are many who give insufficient thought to the future, who perhaps look at it occasionally through rosy spectacles, or with the fears of the pessimist—and then get quickly back to the pressing business of making the results of this year's activity acceptable to the shareholders.

I do not believe that any chief executive need throw up his hands and say that as he cannot foresee every event that will happen, he should not spend his time thinking of the future. There is a process of management which almost any chief executive can make use of if he so desires, which—accepting that there is no certainty about tomorrow's results let alone next year's or the year after—sets out to systematically consider future events against every decision made in the business.

This method of management, corporate long-range planning, is not a technique. It is a complete way of running a business. Under it, the future implications of every decision are evaluated in advance of implementation. Standards of performance are set up beyond the time horizon of the annual budget. The company clearly defines what it is trying to achieve. A continual study is made of the environment in which the company operates so that the changing patterns are seen in advance and incorporated into the company's

decision process. There is no magic in this, so corporate planning cannot guarantee that the company will never again be affected by adverse circumstances: just as when we walk on a crowded city street we cannot always avoid being jostled and bumped—but that is no excuse for walking with our eyes shut! Corporate planning is a way of keeping the company's eyes open.

Planning as a Means to Increase Profits

In my view there can be only one justification for corporate planning: the belief that it can increase profits. Unless a chief executive has this belief, he should not attempt this form of planning, since without a personal commitment he will be disappointed with results.

Now, there are several reasons why planning does contribute to profits.

Firstly, it is a communication process, and so improves the co-ordination in every company practising it. As every manager knows, the problem of keeping the left hand aware of the right-hand's activities occurs in even the smallest of businesses. In large companies, it can become acute. I think we all have our private stock of "horror" stories about the results of poor co-operation. Department X takes an action which affects Department Y, but does not take Y into its confidence. A study is made for the new computer—only the chief executive keeps to himself the fact that he is about to double the size of his company by acquisition or expansion: the result is that the computer is of too small a capacity on the day on which it is installed. Too often different divisions in a company pull in completely opposite directions: each manager thinks he is acting in the best interests of the company, and as no one really knows the intentions of any of them it becomes impossible to get them all into step. Perhaps it is too high a claim to say that corporate planning will solve all co-ordination problems, since there will always remain human failings. But certainly planning will improve the situation, and will achieve more than any other method.

It motivates. The activating influence of a good planning system travels a long way down the chain of command, partly because managers down the line may be involved in the process. The establishment of long-range profit targets gives an indication of the scope of his task to each senior manager, and shows what is expected of him. Above all, the clear-cut sense of purpose, which comes from the setting of objectives, means that everyone has a firm idea of what the company is setting out to become, and is thereby encouraged to help the company achieve its aims.

The third reason is that it leads to better decisions. This is because it brings more factors into consideration, because managers are expected to evaluate the future implications of all decisions, and because it insists on the consideration of alternatives. There is never just one course of action open: planning seeks to apply management judgement to look for the best alternative.

A fourth reason is the attitude towards change which planning generates in an organisation. The modern business operates in an environment of continuous change. Nothing is static. Because of the current state of technology this process operates at a much faster pace than even a decade ago, and at a frightening rate when compared with the turn of the century—a period still within living memory. There is no reason to suppose that the process will slow down, and every reason to expect the pace to increase. It is not only the advance of technology which affects business operations. The energy crisis of 1973-4 and the resultant period of high inflation and economic decline have stressed the relevance of economic factors to the performance of individual organisations. Raw material shortages around this same period demonstrated that the environmentalists do have a message which is of considerable importance to business. Population structures are not static, there is—at least in the Western world—a continual improvement trend in the standard of living which itself alters the balance of consumer desires and needs and causes changes in social values. Channels of distribution are in a constant state of flux. If we add to these the political and legal changes likely to occur we get some idea of the turmoil that faces every business. For many companies any change is—if noticed—regarded as a threat, and too often is completely unobserved until it begins to attack profits. The forward-looking company sees opportunity in the new patterns which will emerge in the future, the chance to adapt the organisation to make additional profits from innovatory measures. Indeed it may actively seek to create change to its own advantage, and to mould some of the trends into the direction it would like to see them go. It does not stand and bewail the buffets of an unkind fate, or look back to history at its past glories. Corporate planning makes the company that uses it a forward-looking organisation.

Planning provides a new way of controlling a business. By providing a realistic model of future results, it becomes possible to adjust strategies to keep the company on target. It makes sure that resources are not wasted and that they become available as required. Of course, corporate planning will

never help a company reach targets that are unrealistic, badly thought out, or the results of pure wishful thinking.

Whether the chief executive accepts that corporate planning can do for his company what it can do for industry at large is a matter for his personal conviction, and it is a mistake to introduce planning without this belief. The rest of this book sets out the basic steps necessary to install and operate a corporate planning system. Only the chief executive can make such a system work.

Where Planning will Fail

In my opinion, there are only four types of situation when corporate planning has a high probability of failure:

* When the chief executive does not believe in it: more, much more, will be said on this later.
* When the chief executive allows no one but himself to make decisions. Of course there are many companies like this, and their size is a function of the ability of the one man who runs them. They are unlikely to be of great size, and without some change in policy (or a new chief executive of the same kind) will die with the entrepreneur who leads them. Successful or unsuccessful, they will all be unable to use the discipline of corporate planning–if only because it is a discipline and has a formal approach.
* The small company that simply cannot afford the time needed to write down plans, and which in any case is so straightforward that all the major implications can be carried in the chief executive's head. The very small companies, that do not employ an accountant of their own, would be wasting their money if they moved into a more sophisticated area of management. While small, they can be very successful without formal planning, and of course have a high probability of remaining small.
* The company that is sinking so rapidly that it requires all those on board to man the pumps. Until it can get the holes caulked and the ship floating it has very little prospect of formalising its planning process. Such a company may, of course, wish that it had introduced corporate planning many years ago, and so avoided the situation in which it now finds itself.

Although these companies may not benefit from the corporate-planning methods described in this book, they must still think about their future. Every chief executive has a duty to think ahead, a duty which he cannot escape. Only in the method he uses does he have a freedom of choice. Peter Drucker sums up the task that all companies face:

> But tomorrow always arrives. It is always different, and then even the mightiest company is in trouble if it has not worked on the future. It will have lost distinction and leadership—all that will remain is big company overheads. It will neither control nor understand what is happening; not having dared to take the risk of making the new happen, it perforce took the much greater risk of being surprised by what did happen. And this is a risk that even the largest and richest company cannot afford and that even the smallest business need not run.
> (*Managing for Results*, Heinemann, 1964)†

It is my belief that corporate long-range planning will enable the company to avoid the fate that Drucker predicts for the unwary and unthinking. Before taking a look at what corporate planning involves, it is worth considering some of the arguments that I have heard used against planning.

Objections to Formal Planning

Some managers make the blunt claim that "it can't work". Frequently this is an unreasoned stock response, used as a defence against something new. In some cases, there is more thought given to planning, and the argument runs something like this: "In my industry market forecasting is impossible, therefore we cannot plan." Now I do not claim that planning is easy for all industries, although the processes themselves need not be complicated. I think that the more difficult it is, the more it is needed and I cannot accept that it is right for a company to opt out of thinking about its future. This is really throwing in the towel before the contest begins. Some of the greatest planning successes appear to come from industries in problem markets. Of course it is my belief that planning does work, but I accept that there are difficulties of measuring cost and benefits.

This leads to the next argument which runs something like this. "Planning is costly in money and management time, and we are not convinced that the benefits outweigh the costs." Of course benefits are almost impossible to measure, since you are always in an "either or" situation. It is never possible to measure what would have happened if you had (or had not) embraced corporate planning. Similarly, although the costs of the corporate planner can

† Quoted with the permission also of Harper & Row, Publishers, Inc.

be ascertained, it is not so simple to calculate the cost of any planning activity undertaken by management: it is of course the additional cost over an informal planning approach which is relevant. Despite these difficulties there has been significant progress in the development of research methods to measure the benefits of planning. A major study by Thune and House ("Where long-range planning pays off", *Business Horizons*, August 1970) proved that companies that planned did better on average than those which did not, and had improved their own progress after starting formal planning. Another study by Herold ("Long-range planning and organisational performance: a cross validation study", *Journal of the Academy of Management*, March 1972) validated this conclusion. Further evidence is offered in a study of the benefits of planning on acquisitions carried out by H. I. Ansoff *et al.* ("Does planning pay? The effect of planning on success of acquisition in American firms", *Long-range Planning*, December 1970.) In all studies there are differences in individual performance, and some planning companies in the samples were outperformed by non-planning companies.

Despite the research, this remains an area for management judgement, and there are many other such areas facing modern management—after all, no one has yet discovered an effective way of measuring the benefits of advertising. I do think companies which do corporate planning properly notice benefits in profit improvement, in internal communication, and in the motivation of people. The key word is "properly" since not all companies with planning departments practise corporate planning. So this is an argument for which the chief executive must act as his own arbiter. All I can say is that there are many companies in the U.K. and the U.S.A. who have made the judgement that it does pay off, and who genuinely feel that for them there is no better way to run a company.

A third argument which I have heard is that surely a formal planning process takes away power from the chief executive. My answer to this is that if it does the person concerned does not deserve to be chief executive! Any planning department he may set up acts only as an extension of himself: while it may bring specialised knowledge to bear on problems, it never makes the decisions. Top management judgement alone must be the ultimate step in the planning process. This objection stems from a complete misconception of the role of the planner in a company.

Another argument is that formal planning will put a burden on line management, will upset them and will take away some of their powers. All this can happen, and many planners complain about difficulties in their

relations with line management. Yet all these problems are usually based on a misconception, since plans should never be imposed on operating managers without their involvement, and a good planner will never do their work for them. Of course, in the course of his work a planner may have to recommend a policy which does upset a particular manager, for example the divestment of a business area, but this is no more than the sort of recommendation the financial director might be forced to make under other circumstances. This problem of obtaining and maintaining good relations between planner and operating management will be discussed in greater detail as the book progresses. It is, where it exists, a human problem, not a fault of the planning concept: although it is a factor which must be considered when a planning process is designed.

What is a Long-range Plan?

Planning has been discussed at great length, without any attempt being made to explain what type of plans will result, or the steps necessary to produce a long-range plan! I am afraid that I tend to use the terms "long-range planning" and "corporate planning" as almost interchangeable. The difference between a long-range and a short-range plan is a matter of degree, and in my view any planning system is incomplete unless it incorporates both. The short-range plan is a means towards making the long-range plan happen, for without action, what is the point of planning?

I would define "short range" as being for a period of up to 12 months, and in the sort of planning system I recommend would have this linked with the budgetary control process.

The term "long range" is relative, and I see this as extending for a period of 3 years or more. The question of for how long a period a company should plan is often raised. There is no stock answer, and each company must make its own judgement. It is important for the period to be sufficiently lengthy for strategy to be developed: any period of less than 3 years is usually too short for this. Major capital investments in, say, a chemical plant may take a long time to complete and the planning period should try to cover a sufficient period so that a realistic picture emerges. A company in the forestry business must think many years ahead, since it may be a very long time before newly planted trees begin to yield. An orchard company may have to consider a 7-year planning cycle, since it may take this long for new apple trees to become economic.

The first principle that can be deduced is that the planning process should take into account any normal cycle of events that is pertinent to the business.

At the same time it is a fact that the shorter the period studied, the more accurately the company is likely to be able to forecast future events. This leads to the second principle, that companies should not plan for a longer period than fits the business they are in. While it might be realistic for our forestry enterprise to plan for 20 years ahead, it is unlikely to be a useful period for an organisation in the theatre business.

I suppose the third principle is that no company should be dogmatic about the time period, but should make sure that it chooses a period which fits its business. Most companies seem to opt for a 3-, 5- or 7-year period. There is nothing really magic about any of these numbers, and I would suggest that 5 years is often chosen simply because it seems to be a nicely balanced unit of time. I would be reluctant to take a period of less than 5 years for any business, because I think a lesser period tends to lack perspective. At the same time, it must be admitted that 3 years seems to suit some companies very well.

Now setting, for example, a 5-year planning cycle does not mean that a plan is prepared at 5-year intervals, nor does it mean that the company should make no study of trends beyond the 5-year period.

What I understand by a 5-year plan is one that "rolls". It may be revised and updated once a year (or more frequently), and at every revision an additional year is added. So there is always a 5-year plan. The plans must be flexible, and the company must be prepared to reconsider the whole of its strategy if events show this to be necessary. What it must never do is write a 5-year plan, and then follow it blindly for the given time period.

The trends beyond the planning cycle will have an effect on the company's strategies. A simple example is the quarrying enterprise whose quarry has only a 10-year life. This fact may well be a major influence on the first 5-year plan, since it may restrict the investment the enterprise is prepared to put into the quarry, or cause it to search for some other area of activity so that this can be well established by the time the quarry is exhausted.

Both these points are really a statement that the far-sighted company will apply good sense and business judgement to its plans. Slavish attention to a set of rigid rules can well mean planning with defective vision. The fact that a company goes to the trouble of writing a document does not mean that it is in fact planning! I personally believe that the act of planning is more important than the written plans themselves.

It may be that the company will wish to have two or three planning time periods. It is often very sensible to consider a project plan for a period of much longer than the 5 years laid down for the strategic plan. Also, it may be wise to plan strategically for 5 years, but to only produce operating plans for a 3-year period: I have never found this necessary, but this is the way some companies work.

The Types of Plan

The three terms "project", "strategic" and "operating" plans require definition because they are quite different types of plans, although all highly important to the company practising corporate planning.

A project plan is a plan covering a particular capital investment or marketing operation. For example, an investment in a new factory would be supported by a detailed study of the expected results of that investment. Project plans are prepared on an "as required" basis. This does not mean they have no relation to the other plans, since they must fall within the framework of these plans. Obviously a company would be planning badly if it had to prepare a project plan for a major investment that was not mentioned in its strategic plan. It is of course possible to carry out project planning without doing corporate planning.

Strategic and operating plans are within the regular planning cycle discussed earlier. Put simply, the strategic plan sets out the objectives of the company and the means (strategy) by which the company intends to reach those objectives. An operating plan is the plan of an established area of the company—for example, a division or a subsidiary. This definition is important for the sense in which these words are used throughout this book. As in all management subjects, there is really no common ground of meaning in the use of these and many other key words, and some writers use the terms differently.

Now we cannot leave the definition of strategic and operational planning hanging in the air, for there are other plans which are bound up with them and there are inter-relationships that must be explained. Figure 1 shows a generalised family of plans which a company might develop. I say "might" because practical application of the principles will often suggest changes to suit the particular situation of the individual firm. The whole system is described below to give a coherent picture, but each element receives more extensive treatment in later chapters.

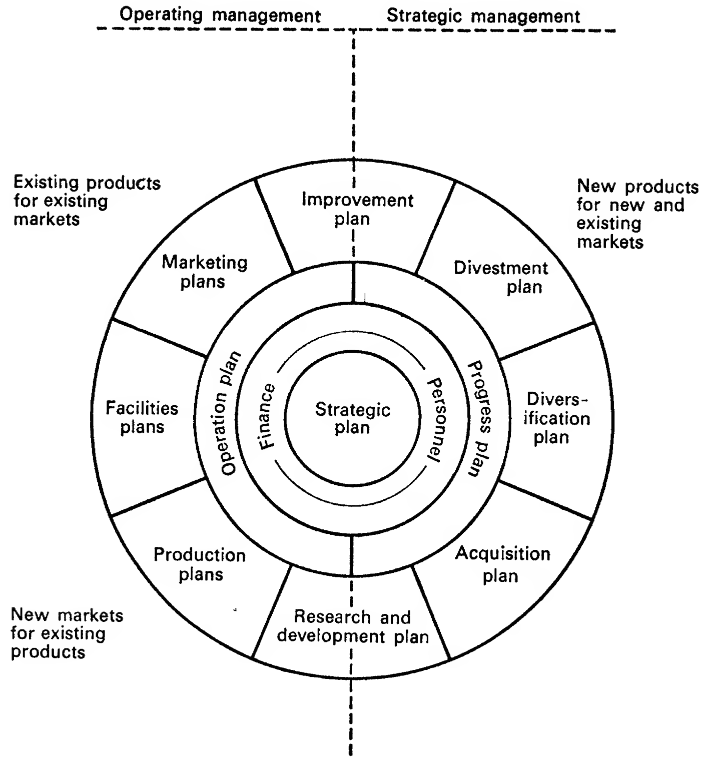


Fig. 1. Generalised planning system.

The diagram is in circular form to indicate the fact that not one of these plans is an entity on its own—each depends partly on the other plans in the system, and indeed, during the completion of the plans there is a feedback from one plan to the next.

In the heart of the system is the strategic plan, which was defined above. This really is the key to the whole process, and from this will come strategic guidelines to the operating units of the company. Surrounding the strategic plan is another circle, which is split between the financial and personnel plans. These, too, are master plans for the whole company, which show how the programmes in the strategic and operational plans are to be provided with the twin resource requirements of money and people. Naturally, these must

balance with the total corporate strategy, since if there is a shortage of resources, there may have to be revisions to strategy.

All the operational plans are found on the left-hand side of the diagram. The dotted line has been positioned to emphasize that there is a direct relationship between these plans and the three master plans. The diagram assumes a simple one-division company, but it is easy to see how the plans shown on this side of the diagram can be repeated for additional divisions and departments, right down to the smallest unit to which the chief executive wishes to bring long-range planning. The headings here are quite straightforward and fairly logical, covering marketing, production and facilities. Shown partly on this side and partly on the right-hand side are the improvement plans and the research and development plans.

The right-hand side of the diagram shows the family of plans, also descending from the master plans, which are the responsibility of the strategic management of the company—in other words, the chief executive's plans, although of course he would probably find it advisable to use staff assistance and should certainly call on his top management team.

Research and development, and the improvement plans fall under the influence of both strategic and operating management. The normal operating unit may use R & D to constantly improve its products, to produce new ideas in line with its current operations. On the other hand, strategic management may call on R & D to develop the product or technology which will take it into a completely new business area. Improvement of all operations is a total management task, and a striving for increased productivity and for greater profits through higher efficiency is such an important issue that I like to see a special plan devoted to it.

The rest of the plans on the strategic side show the other major groups of alternatives open to a company—expansion, acquisition and divestment. These three headings, plus the other two, really sum up all the types of action that the chief executive can take to reach an increased profit target. He can make his current operations more efficient, and reach it in this way. He can decide to expand his capacity, open a company overseas, buy up some licences—hence the expansion plan. He can find new areas of activity through his R & D—or he can go off on a shopping expedition and acquire his way into new areas of profits. He may have to get rid of some of the areas in which he at present operates—hence the divestment plan.

At this stage, I must confess that the word plan still tends to suggest to me an image of a huge leather-bound document, perpetually locked, and hidden

deep in the company archives. I do not think I am alone in this—for example, I once had a perfectly serious enquiry from an acquaintance who wanted to know what a strategic plan looked like, and how long it was. "Plan" must not be interpreted in such a way in the conceptual approach I have outlined (no corporate plan should ever gather dust in the archives!) and in many cases the whole "plan" may be only a few sheets of paper. In other cases it may be long enough to make up a file or a book. The objective should, of course, be to keep plans as concise as possible, but at the same time they must include enough data to make them actionable. There is some merit in having the various parts of the total package so that they can be lifted from the whole: because of its confidential nature, it may be advisable to restrict readership of the total corporate plan. In this case, various sub-plans may be taken from the whole, and passed to those people who have to take action on them.

The total approach discussed above is for a company which has embraced the corporate planning method. Just as it is possible to carry out project planning without corporate planning, so it is possible to do operational planning or strategic planning in isolation. But real success can only come from undertaking both.

The Total Planning Process

Plans such as those described do not suddenly come into being. In fact, one might claim that they are the middle part of the planning process. Figure 2 shows the various steps which have to be followed before a company can justifiably claim to be approaching the task of planning in a formal way. Each of these steps is vital to the success of planning in the company, and each is described in full detail in later chapters. At this stage it is only necessary to obtain an impression of the total task facing the company.

Preceding the diagram is a decision to do planning. This is a big decision, for it will cause radical changes to the pattern of management within the company. But it is important to realise that it is a decision.

There are a number of possible starting places to Fig. 2. I have chosen the environment, because corporate planning involves acceptance that the company is not operating in a vacuum, and that it is affected by what goes on in the world around it. The market has been shown as a separate element from the other environmental factors, affected by them, and vitally important to the future of the company. A later chapter deals specifically with market planning.

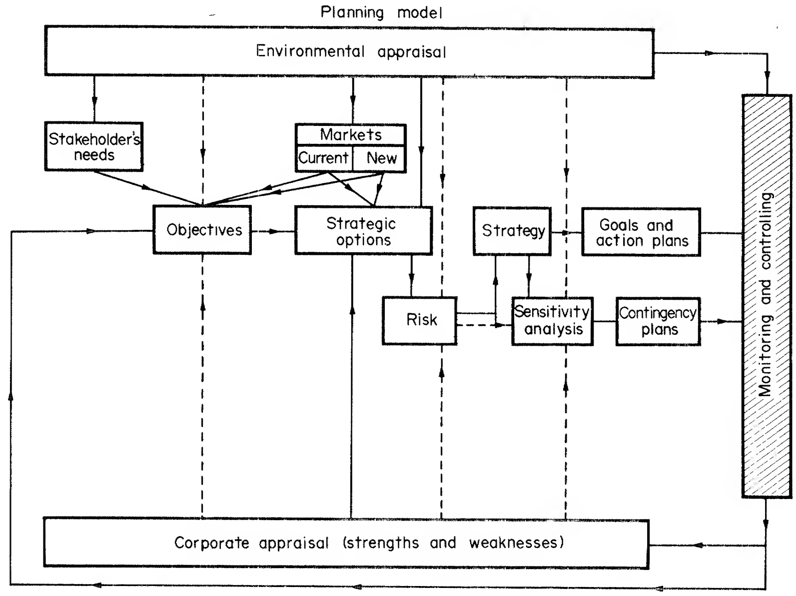


Fig. 2. The total planning process.

The environmental appraisal seeks to establish what external events really do affect the company's operations. Equally important, it is designed to provide the company with assessments of future trends, to indicate areas which are likely to change in the years ahead; in order that strategy may be adjusted and the company moulded to a new pattern of operations.

As all forecasts of trends are, at best, only forecasts, it will be necessary to reduce these to assumptions for planning purposes. Any plan which provides for future events must be based on assumptions; the corporate-planning process insists that these are clearly defined so that all concerned with planning know what they are. It also makes it possible to monitor them to measure when things go wrong, so that corrective action can be taken before the effects are felt on profits.

Monitoring and controlling is seen as a step affecting the whole process, with direct impacts on the corporate appraisal and the rest of the process. Although illustrated as one step, in practice it will be made up of as many

sub-systems as is needed, and different elements of the model will be controlled in different ways. It is a critical stage in a planning process, and should be a regular, continuous system.

At the bottom of Fig. 2 is a box indicating the corporate appraisal. This is a very important step, but is often neglected. Some companies argue that planning should have no connection with present operations: the "don't rock the boat" philosophy. This is nonsense, and unless a company is willing to put itself under a form of self-analysis to assess its strong and weak points, it might as well give up the idea of planning. The corporate appraisal helps the company to understand its present interface with its environment. It defines, in effect, the unique corporate identity which is the feature of every company.

Many would argue that the true first step in any plan is the definition of objectives. The diagram shows that the primary objectives are in part a response to the way in which the chief executive decides to meet his interpretation of the expectations of the stakeholders. The stakeholder concept embraces all with an interest in the firm: shareholders, employees, the community, customers and suppliers. Although the non-shareholder interests may modify the degree to which profit is sought, we should not forget that adequate profit is necessary for the survival and growth of the business and therefore ultimately to meet the expectations of the other stakeholders. The determination of objectives is an area of conflict, since everybody cannot be satisfied to the degree that they might wish.

Objectives may require reconsideration during the various stages of the preparation of a plan, and are shown in the diagram as being influenced by stakeholders, the environment, the market, the appraisal and the feedback of results against strategies. In simple terms the objectives might be said to include a profit target, definition of what the company's business is, and a statement of what it intends to become. This brief description will be expanded later.

Other stages in the model show the identification of strategic options, and the consideration of their risks, leading to a selected strategy which is subjected to sensitivity analysis to "test" its vulnerability. This is the heart of the analytical framework of the strategic plan, and leads to goals and action plans. These effectively are the particular operational and strategic sub-plans discussed in Fig. 1.

In turn this leads to the monitoring of results against plan, and the feedback mechanism already discussed.

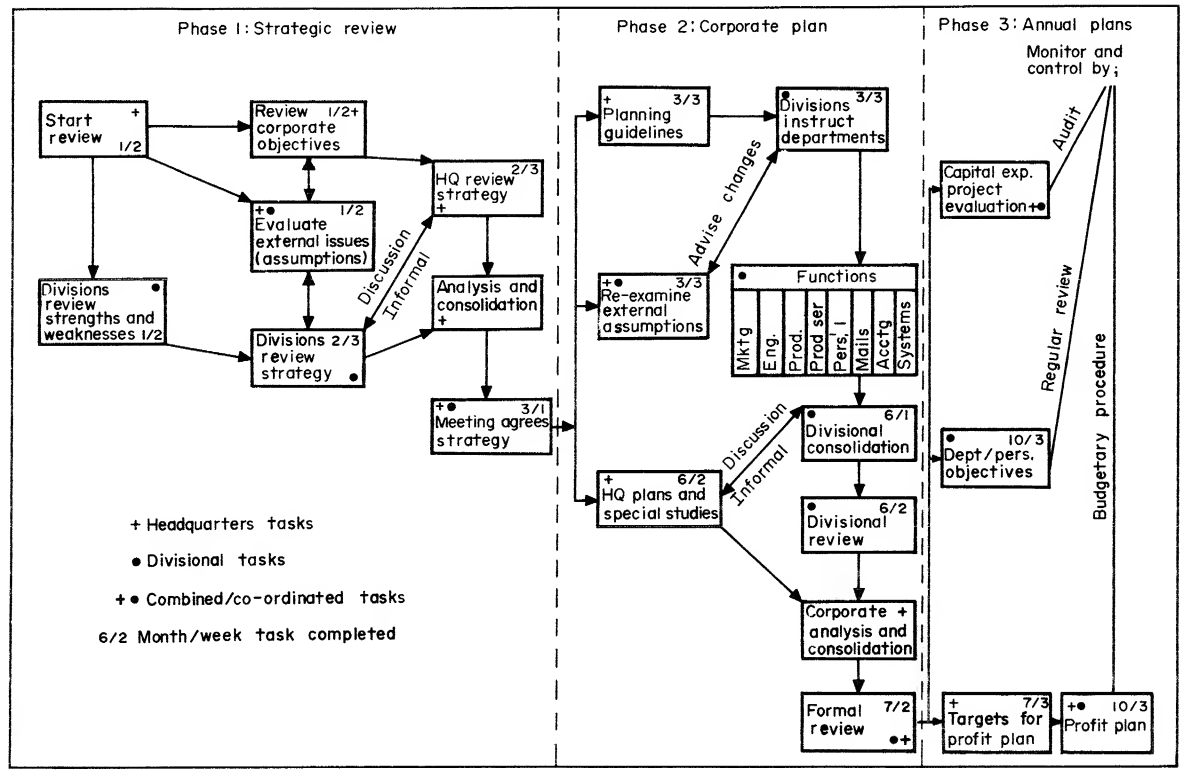


Fig. 3. Rolls-Royce Motors Ltd. – outline planning process. (From Corporate Planning at Rolls-Royce Ltd., R. Young and D. E. Hussey, *Long Range Planning*, April 1977.)

We are now very close to the design of a planning process. This takes Figs. 1 and 2 and combines them in a way that will meet the unique requirements of the individual company, so that the resultant process clearly shows not only what analytical steps are needed and what plans will result, but *how* the company will tackle this task and *which* organisational units will be involved.

In addition, the complete process has to bring in the concepts of time, and the subdivision of the various tasks into steps to be completed by a defined date. Overall the process is continuous, and designed to lead to the formal revision and extension of the plan every year. Within the process provision must be made for formal reviews of the plan, and the dissemination and formal discussion of the strategic guidelines which enable operating divisions to make their plans.

The final links which complete the process are forged with other systems in the company: for example, budgeting control, capital budgeting, project and capital expenditure evaluation, personal appraisal and management development.

There is no universal flow chart which will illustrate the process in a way which fits every company. The best that can be done is to show a summary diagram of the process as it is applied in a particular company: this is illustrated in Fig. 3.

This chapter has dealt at length with some broad issues. Having disposed of these we can now get down to the more practical problems involved in introducing planning and making it work. Figures 1 to 3 should be kept in mind as the various parts unfold over the following chapters.

Corporate planning is a total process. It must involve the whole company, and the emphasis now to be placed on particular aspects must not lead us to forget the very important relationship that each has with the whole.

CHAPTER 2

BEGINNING THE PLANNING PROCESS

The Principles of Planning

If corporate planning is a philosophy of management, it must have certain principles. These are not very complex, and can be superimposed on a variety of different theories of management. What they really do is give a particular slant to the way in which the company is run. The only thing with which they are incompatible is poor management (which is not, of course, accusing those companies which do not do long-range planning of being badly managed). All the principles of planning fall within the definition of management given by Harold Koonz ("Making sense of management theory", *Harvard Business Review*, July–August 1962).

> Managing is the art of getting things done through and with people in formally organised groups. It is the art of creating an environment in which people can perform as individuals and yet co-operate towards the attainment of group goals. It is the art of removing blocks to such performance, a way of optimising efficiency in reaching goals.

The principles of the corporate planning approach are worth examining, because they are vital to the successful introduction of planning to a company. Acceptance of the principles means that planning will never become an empty exercise, and will mean that plans work–and that the carefully prepared long-range plan does not disappear into the files for a year, unread and unused.

That well-known journal *The Economist* (5 October 1968) published an article on corporate planning which asserted that planning grew out of one of three areas: the market research/forecasting function, the budgetary control function, or an *ad hoc* team set up to appraise a major capital investment. In fact these are all bad approaches to corporate planning, which should be introduced as we saw in the last chapter as a deliberate decision by the chief executive that this is the way he wants to run his company. Growing into

planning is the wrong way to go about it, and can jeopardise its chances of success.

There is a body of research evidence which suggests that planning frequently is introduced as an answer to a crisis: either internal, such as a change in top management, or external such as the energy crisis. It is a pity that this is so, for an earlier introduction might well have avoided the crisis.

So this is the first principle: that the chief executive must genuinely desire corporate planning, and he must back his wishes by positive action. Planning must not only be wanted, but it must be seen to be wanted—which means that the chief executive must excite among his senior managers the same desire to practise the planned approach which he himself possesses. He, too, must submit to the same sort of planning discipline as the rest of the company, for nothing is worse for the success of planning than the feeling that this is medicine that the chief executive reserves for those under him—but which he will never take himself. His personal interest in the planned approach must be as obvious to the company as his edict that this is the philosophy by which the company will be guided.

H. Kirby Warren conducted a very interesting survey among various levels of management in a number of leading American corporations which did long-range planning (*Long Range Planning—The Executive Viewpoint*, Prentice Hall, 1966). He suggests in one of his many findings that managers have a "wait-and-see" outlook to the introduction of planning: they wait until they can see just how seriously the chief executive treats planning before they decide on the amount of effort they themselves will put into it.

Of equal importance is the principle that all managers must be concerned with the long-term results of all decisions. The shape of the company in the future years ahead depends on decisions made today. The planning company makes it a cornerstone of management that all managers look beyond the short-term results of their decisions. This goes far wider and much deeper than the mere writing of plans. It spans every management level in the company, including people who might not normally be involved in the preparation of formal plans. Every manager is motivated to evaluate the total logical outcome of his decisions, and not to make them solely against the background of pressures of the day. Under this philosophy a manager who ignored the future effects would have this counted against him when his performance was appraised.

The corporate-planning system forces managers to accept that there is always a choice of actions possible, and that part of their job is to make the

best choice. This enforces the consideration of alternatives, and the deliberate definition of all the practicable ways of solving each particular problem. The solutions sought will not simply be the ones which spring first to mind.

This leads on to the next principle which is that all such decisions must be made objectively, after consideration of the available facts. This suggests that appropriate management techniques should be used in the decision process. It presupposes an effective management information system, and a flow of data on the environment, so that reasonable alternatives can be considered. Above all, it calls for an attitude of mind that attempts to banish emotionalism from decision making.

As there is a proper evaluation, the results should be recorded. Wherever possible the expected effects of the decision should be quantified, to provide a simple model against which performance can be measured. This leads to the principle that as much as is reasonable in the management task will be written down. One of the reasons for a permanent record of the problem, the alternative solutions, and the reason for choosing the decided course of action is that the act of writing focuses the mind, and leads to clearer thinking. Too often, companies make important decisions without ever setting down what they are hoping to achieve—and if you do not do this, how can you know when you get there? And, of course, another reason for a written record is that it becomes possible to monitor results to confirm that the standards set *a priori* are in fact achieved.

The principle of recording extends to such areas as company policies, job descriptions and the like, so that there can be no possibility of a manager misunderstanding something which is vital to the optimum performance of his job. There are too many misunderstandings (when, for example, a senior manager delegates a task to a subordinate), caused purely and simply by bad communication. The senior man thinks he has issued clear, concise, verbal instructions; the junior thinks he perceives exactly what is expected of him. But there may be no common ground of understanding. The tragedy is that in some cases neither party will ever know. On a different front, it is well known that many companies are disappointed with their market-research results, or pay more than they need to for a survey, simply because there is no written brief to the marketing research department to set out clearly and concisely what information is required, and why.

A secondary benefit of clearly defined policies is that it becomes easier to modify them as circumstances change. If a policy is written it becomes obvious when it is no longer appropriate: if it is not written, the chief

executive will make a series of mental adjustments to it—half of which he will never pass on to his staff.

I like to think of corporate planning as a team approach. This leads to the principle of involvement of those concerned with implementing decisions during the making of those decisions. Managers must function as a team, and there must be opportunities for discussion both along the various levels of management and up and down the line. Where possible, junior managers should be allowed to contribute to the solution of a problem. Senior managers should be aware of what their counterparts in other sections of the company are trying to achieve. Snap decisions will only be made when this cannot be avoided, since there is no merit in making decisions at a faster rate than is needed, when the too hasty action has a high chance of being wrong, and when the available facts are not taken into account. This is not the same as saying that *necessary* decisions are avoided, or that an immediate response cannot be made when circumstances require.

Thus planning is a very important communication process. There must be adequate discussion between chief executive and line managers, so that plans have both the involvement of those responsible for them, and the approval of the man whose duty it is to set the overall pace of the company. It follows that if management is a team approach, there must be a naturally healthy atmosphere for the discussion of problems and the development of ideas.

The planning process should try to encourage the growth of ideas from all areas of the company, and the open approach so necessary for good planning stimulates this result. Good, sound, business opportunities can come from many corners of the company, and are a diet needed for the continued well-being of the body corporate. The aim should be to gain true management involvement in planning the future of the company in a way which allows senior management to contribute to the development of strategy, and more junior management to have a wider participation than planning their own responsibility areas.

Perhaps the last principle is that the spread of the planning approach throughout the company must be total. You cannot claim that this way of management includes everyone except Bill Smith ("who is difficult"), or the Personnel Department, or Production, or whatever other departments spring to mind. The planning philosophy must go all the way through the company, and every one in the company must learn to approach his problems in the ways described. But this also means that sufficient data must be made available to enable everyone to plan. This does not mean that no secrets may

be withheld from the office junior; but it does mean that the Personnel Department (for instance) must be aware of the major developments taking place in the company. The principle of communication again.

The task of planning the progress of the company lies squarely on the shoulders of the chief executive, just as the task of planning his own operations is part of the job of every line manager. These cannot be delegated.

Fig. 4. A check list of reasons why planning may fail

1. Faults of the Chief Executive

   A. He does not believe in it, but has a planner because it seems the thing to do.
   B. Insufficient backing by chief executive leads line managers to underestimate its importance.
   C. Instructs planner to take no interest in current activities and to avoid upsetting line managers.
   D. Gives planner too low a status for him to be able to converse with general managers on equal terms.
   E. Creates a planning committee rather than give planning task to one individual.
   F. Allows some managers to opt out of the system.
   G. Spends too little time on planning.

2. Faults of the Planner

   A. Tries to do all planning himself.
   B. Planner of low calibre.
   C. Planner has only a part-time interest in planning and has to spend too much time on other activities.
   D. No control mechanism or other procedures to convert plans to action included in the system.
   E. Planner a narrow specialist who lacks ability to see full scope of his task and views planning only in terms of his own discipline (e.g. O.R., accounting).
   F. Lack of attention to one or more of the basic steps.

3. Faults of the Company

   A. Company as a whole does not understand the corporate-planning process (not all companies with "planning departments" carry out formal planning).
   B. Managers judged on current results only and no account taken of their future plans.
   C. Company tries to move into an advanced management area before it is ready (e.g. companies with no accounting function).

The Corporate Planner

The preparation of formal plans involves much detailed work; even more important is the time needed to study the trends in the environment, to make sure that the company can take advantage of all opportunities. In all but the

smallest companies, the volume of work in organising and preparing plans and in the evaluation of alternatives is such that the chief executive just does not have the time available to do the task justice: indeed he should have priorities in his own work task which would put much of the *routine* of planning in a fairly low position. This is why most companies that do corporate planning employ the services of a planner. Now this does not suggest that the chief executive delegates the task of planning; nor does it mean that line managers can throw up their hands and say that as the future is now being looked after they need give no more thought to it. A good planner will never try to take the chief executive's decisions for him, though he will certainly ease the burden by objective analysis of alternatives; illuminating opportunities; and taking over many of the problems connected with making planning happen. Similarly he will never try to do the planning for line managers, although he certainly has a duty to help them, and although the processes he gets working will ensure that they are able to take more factors into account when they do plan. In all this activity he is nothing but an extension of the chief executive.

This is not to suggest that he should be a "yes" man. He should present his own opinions to the chief executive, and should make suggestions that will improve the way in which the company moves towards the attainment of its objectives. His role must be an active one, and he must never fall into the passive situation of being nothing more than his master's letter box. But at the same time he has no right of position to impose his own schemes on to the company.

There is no substitute for the employment of a full-time corporate planner. Reality does not always fit in with what is best, and the smaller company may have to appoint someone who has another major role besides that of planning. This is not the best situation, and the plans will suffer for it, but obviously the amount of resources which a company can afford to devote to planning must be taken into account. But the situation should be avoided, if this is at all possible.

The opposite of this situation also applies, and some companies find it necessary to employ more than one planner. My own view is that the optimum-sized planning staff is one, and that any increase in numbers over this represents a degree of relative failure: my only exception to this principle is where the complexity of operations makes it worth while attaching additional planners to major subsidiaries—particularly important in a company operating in a number of countries, or in a very diverse field of activity.

It may happen that the sheer size of the planning problem in a large company makes it imperative for the one-man principle to be left behind, and that additional people will be required to study opportunities and environmental factors. If this is really justifiable, then it has to happen: but this is a far cry from the over-large planning departments built up by many companies, on the assumption that as planning calls on many disciplines, you have to try to have an expert in each. What so often happens, of course, is that functions which exist elsewhere in the company are duplicated in the planning department: an empire is created which is justifiably resented by line management, and there emerges a form of ivory tower planning which becomes more and more remote from the real affairs in the company.

Now of course planning calls for expertise in more than one area, and no planner can be a leading expert in every one of the disciplines or techniques he may have to call upon. But there is a good deal to be said for the designing of a planning process which makes use of existing talent from within the organisation. I very much favour the "task force" approach which establishes a team from different areas of the company to perform a specified job: examples are a task such as the corporate appraisal, or a capital expenditure evaluation. The big advantage of the task force approach is that it is possible to include representatives from the operating areas of the company that will be concerned with the outcome. Line management is involved from the beginning and there is no suspicion of an imposed solution.

One thing that fogs judgement about the size of planning departments is the habit which some companies have of attaching other functions to the planning manager: marketing research, operations research and general trouble-shooting. In principle this is incorrect, because apart from giving the appearance of an empire, it means that the man in charge has a number of administrative duties which restrict the amount of time he has available for the all important task of planning.

By the nature of his position as an extension of the chief executive the planner should report to no one but the chief executive. Anything else is wrong, and puts a blockage between the man who carries the responsibility for planning and the person he has recruited to help him. It follows that the planner must be of a calibre suitable for the position he holds. It is very damaging for the chief executive to claim to be too busy to have the planner report to him: all this suggests is an attempt to abdicate from the responsibility of planning, and the chief executive can only do this if he surrenders his position as chief executive. The planner should be able to

communicate on equal terms with the most senior managers of the company, and reporting to the chief executive helps this to happen.

The selection of the planner is a very important step in the planning process. He must be able to make objective evaluations and must be numerate. He must be able to "sell" ideas to people, and must therefore be able to express himself, both verbally and in writing, and, of course, he must be of the calibre to inspire confidence in line management.

Planning calls for the use of many skills, and it is highly improbable that any one person has expertise in all of them. This means that the basic discipline in which he is trained is not of vital importance–he can be an economist, econometrician, mathematician, or virtually anything. As wide a knowledge of techniques as possible is a desirable feature, but the planner should never be a narrow specialist, appointed *because* he is an economist, O.R. man, or the like. The other qualities required outweigh the narrow skill, and of course are found in a very wide range of people.

The planner should preferably possess, or at least be able to rapidly acquire, an expertise in corporate planning. It takes a certain skill to design a system of planning for a particular company, and much wasted effort can be avoided if the planner knows what he is doing.

When the chief executive decides to appoint a planner he has a "make or buy" choice. He can take a suitable person from within his own organisation–and if he does this he should choose a manager who "cannot be spared"–or he can buy in the services of a person with appropriate corporate planning experience. It is up to him to make up his own mind, for there are advantages in both choices.

Obviously, his own man will already have an extensive knowledge of the company's affairs, and should have the appropriate personal standing with other managers. (If he is a man who can be spared then he may not have this personal standing.) But lack of knowledge of corporate planning could set back the introduction of planning several months, and to precipitate an action through ignorance of what to do, can do the planning cause a serious disservice.

On the other hand, the buying in of a planner will mean that there is no period of hesitancy while he studies corporate planning methodology. He will not know the ins and outs of the business, but this may be an advantage, because he will not have his mind cluttered with attitudes carried over from his previous jobs with the company. He will not know what is impossible. It is important not to overestimate the length of time a person of the right calibre

needs to obtain enough knowledge about the company to help planning start. Some managers think that as it has taken them 30 years to learn the tricks of the trade in which they operate, no person could possibly gain a working knowledge in a period of a few weeks. There is here a confusion about the nature of the knowledge required. The planner has to know enough to understand the business—not necessarily enough to be able to personally perform every task in that business. In the fruit trade, for example, the planner would have to understand the supply/demand pattern for apples, and the functioning of the channels of distribution: he would not have to learn how to personally recognise the differences between a Cox's apple, a Golden Delicious, a Granny Smith and a Worcester.

One further point of importance in the selection of a planner is that, if the choice is for "making" a planner, the man selected must be willing to take on the task. Impressing a reluctant line manager (who may regard his planning duties as a temporary spell of penal servitude, and forever look forward to his release into the real world) is not a good move. The man chosen to fulfil this key role must have a certain amount of dedication to his job. If he, personally, is unenthusiastic it will be the harder for him to convince the other members of the management team that corporate planning is a worthwhile thing to do.

Fig. 5. Job description of a corporate planner

Title:	Corporate Planner
Reports to:	Chief Executive
Purpose:	To assist top management to plan the future of the company in an orderly way.

Principal responsibilities:

1. Introducing a system of formal long- and short-range planning covering all areas of the organisation.
2. Assisting management in the definition of objectives and goals.
3. Identifying long-term internal and external factors and their potential effect on the company.
4. Assisting the Chief Executive in the development of strategies to achieve corporate objectives.
5. Analysing and making recommendations on alternative courses of action, including capital investment, acquisitions, divestment, and expansion.
6. Ensuring that the future implications of all decisions are taken into consideration.
7. Appraising corporate strengths and weaknesses.
8. Advising all management levels on planning matters.
9. Writing strategic plans to reflect the decisions of the Chief Executive: co-ordinating the plans of line managers.

10. Monitoring plans and the assumptions on which they are based so that the Chief Executive can control progress.
11. Maintaining a manual to describe the planning system and to specify the part each person has to play in that system.
12. Initiating special studies and research appertaining to the future of the company. (Where available, working through appropriate departments within the organisation.)
13. Training management in planning principles and methods.
14. Applying appropriate techniques to the solution of problems.

Qualifications:

Should be qualified to degree standard in an appropriate discipline, but should not be a narrow specialist.

A wide range of disciplines are suitable—e.g. Economics, Business Administration, Market Research, Mathematics, Statistics, Marketing.

Experience:

Should have experience of corporate-planning principles and methods, and ability in some management techniques (ability in ALL techniques is virtually impossible). Appropriate techniques include:

D.C.F.
Risk Analysis.
Network Analysis.
Decision Theory.
Marketing Research.
Forecasting.

Should also be thoroughly experienced in management theory and philosophy.

Must be able to express his thoughts fluently both verbally and in writing. Must have integrity in his approach and must not be afraid to make recommendations that may be unpopular.

Must be able to communicate with all levels in the organisation.

Age:

Not younger than 30.

Planning the Plan

At this stage we have covered the selection of the planner and must now consider the situation when the right man has been appointed into a company where the chief executive has been at pains to create the right climate for the success of corporate planning. It is worthwhile thinking about some of the steps which the planner will have to take to make planning happen. This is when the chief executive's decision to undertake the corporate planning approach begins to move very definitely into the action phase.

It seems to me that the planner has a number of things to do before he can set a planning system into motion. This really is a pre-planning stage, when time must be taken to "plan the plan". As I see it, he has four basic steps to take:

1. Self-education.
2. Management education.
3. Design of planning system.
4. Issue of planning instructions.

The only problem with writing down a series of steps is that there immediately appears to be a neat ordered sequence. In practice the steps all have blurry edges: some will be started before others have finished, and in the middle of it all the planner will be beginning those elements of the planning process which have to be carried on, regardless of the final shape of the system. Objectives will be set, the corporate appraisal begun, and, because he will be walking into a dynamic situation, there will be *ad hoc* situations which will require his attention. Only in a company that begins corporate planning before incorporation is it possible to prevent anything happening until the planner is ready for it! So there will be capital investment decisions, new products and a thousand and one other decisions which will make claims on the planner's attention, long before he has helped the company to produce its first long-range plan.

With this in mind, it is possible to interpret the four steps in the way in which they will occur in the hustle and bustle of the normal business environment. And, of course, order will gradually appear out of the apparent chaos.

The first step has really been covered in the description of the planner himself. If he has been appointed from within, and has no planning expertise, his first task must be to acquire some. If he has been hired from outside he must first learn enough about the company to begin the other steps: but in this case the learning can be linked with the preliminary moves towards the corporate appraisal. In any event, step one should not last more than a matter of weeks (although this does not suggest that the planner should then close his mind and assume he knows everything!).

The next stage is a vitally important one. Something new is happening in the company which will affect the life of each and every manager. It is only fair that a determined effort is made to explain what is happening: it is not only fair, but it is prudent, since many misunderstandings can be avoided if

managers are shown what planning is before any other demands are made on them.

The development of managers' knowledge of methodology can be approached in two ways. Firstly, in his first few weeks the planner should meet as many managers as possible, to "sell" planning to them, and to establish good interpersonal relations. At this stage the planner may still be eyed with suspicion, but at least he will have shown that he is flesh and blood, like everybody else.

It is also useful to hold an internal seminar (or series of seminars) to explain to managers the full implication of planning, and the theory behind it. In some companies, a guest speaker can be used to advantage—on the basis that many managers are more likely to believe what they learn from an outsider, than what they are told by someone whose salary they are paying.

The handling of these meetings is important, for they can shape line managers' future attitudes to the planner and to planning. Depending on the requirements of the company, it may be worth holding seminars for different levels of management: each should, of course, be pitched to appeal to the particular responsibilities of the managers attending. A professional approach is important in the holding of any seminars, for all managers will be giving a little of their most precious resource—time—and this must not be wasted. In many situations it may be necessary to develop a more comprehensive course or programme. Specialist outside help will usually make this a professional and effective initiative.

During the whole of this educational process, the chief executive should by his behaviour show that he fully supports his planner. It would be a very bad start to planning if the chief executive were to announce that he was too busy to attend the seminar. His presence is vital to convince managers that he is serious in his intentions.

Many corporate planners believe that planners and line managers are incompatible: that at best there is an armed neutrality between them: at worst open hostilities. I do not accept this point of view, and I believe that any good team of executives can work within the planning framework, provided the right relationship is established from the beginning. The second worst mistake a planner can make is to give the impression that he is going to do all the company's planning himself from now on, and that the managers are his little chess-men whose function is to put the plans into operation. (The worst mistake a planner can make is to *really* try to do all the planning himself! Unfortunately, some do.)

There will be many decisions to be taken on the design of the planning system. It is almost certain that the conceptual approach outlined in the previous chapter will be recognisable in whatever system is adopted: it is absolutely certain that the final system will have important differences. The unique needs of the company must be taken into account, and the ultimate scheme should slide as neatly as possible into the company's way of doing things.

Every company is likely to have in existence some semi-formal elements of planning, and there is almost certainly bound to be a process of budgetary control. It is worthwhile using these existing elements as building blocks where they are suitable. Similarly, the basic organisation chart of the company should provide a framework for establishing the exact contribution required from each person—although, of course, it must not be forgotten that the corporate appraisal may show the need for changes in the organisation. I do not think the planner can expect that the first system he designs will be absolutely perfect: he should expect to make changes as time progresses, both to meet the needs of a dynamic organisation and to improve on his original ideas. In this way the system will be a flexible part of a living company.

It is considerate if the planner can try to avoid the busiest planning periods falling in the time of year when managers are most stretched. Of course, this is not always possible, but where a clash can be prevented it will make for the smooth running of the system, as well as giving the managers more time to think.

The Planning Manual

Planning is a system of communication, and the system must build in opportunities for interdepartmental discussion, as well as discussion up and down the line. Once all the details of the planning system have been decided they should be presented in written form to all involved. The basis of this record should be some form of planning manual, which should show very clearly what part every manager is expected to play in the planning process. I think it is a waste of time for anyone to approach a line manager with the request to "prepare a 5-year plan by next Friday", unless he is also given guidance on the sort of problems he is expected to consider in the plan (and a reasonable period of thinking time). So the planning manual should set this out in full detail.

There are other reasons for a manual. One of the duties of the planner is as

a co-ordinator. He has to make sure that every division in the company plans in the same direction. Certain basic data are needed for every plan, and the contribution of each line manager must contain these data.

Possibly even more important is that a good planning manual can save time for the line manager. His time is valuable, and there is no reason at all why he should waste it on a detailed consideration of the conceptual outline to his plan. This is something the planner can—and should—do for him.

The usefulness of a manual can be increased if a brief introduction is given to the whole process of corporate planning. This is necessary because, despite all the preliminary groundwork of the planner, corporate planning will be an unfamiliar activity to many. If the planner lacks interest in writing such an appreciation himself, he can meet the need by purchasing reprints of a suitable magazine article. It would, of course, be a mistake to assume that all managers will read this particular part of the manual, but some of them will and if only one plans the better for it, the preparation time will have been well spent.

The aim of the manual should be to record all the more permanent elements of the company's planning system. The many additional instructions that vary with every plan such as planning calendars, strategic guide-lines and assumptions, should be dealt with by letter before the beginning of each planning cycle. This also provides an opportunity to remind managers that the cycle has begun.

There is one very real danger in the formalisation of planning. The standardisation of plan layout can bring the risk of a standardisation of thought, which would be disastrous to the company. If planning ever becomes a form-filling exercise in the eyes of managers it will be well down the path to failure. To be successful it must stretch the imagination of each manager, and must force them to throw their thoughts into the future. The planning process should be more valuable than the plans themselves.

Any plans that have become dreary "form-filling" will have little value to the company. Now this is an avoidable situation and action starts with the planning manual. When writing the instructions to managers the planner must stick to essentials, and avoid petty detail. He should also try to leave the manager a certain freedom of choice. For instance, it is worthwhile providing a conceptual guide-line for market planning, so that all can see the sort of approach required, and the areas of decision to be covered: but he might be unwise to insist that his framework was adhered to rigidly. Having given the guide-line, he should encourage managers to approach the problems in their

Fig. 6. Suggested outline of a planning manual

CONTENT

Part 1: The Background to Formal Planning

(a) Description of the Formal Planning* approach and processes.
(b) Marketing Planning.
(c) The value of the Gap Analysis Technique.
(d) Features of a good plan.

Part 2: An Overview of the Total Integrated System of Short- and Long-Term Planning in the Firm

(a) The total system
(b) Marketing information required for plans.

Part 3: Long-range Planning Procedures and Systems

(a) The types of long-range plan which form the system.
(b) How these are co-ordinated.
(c) Assumptions.
(d) Methods of dealing with risk and uncertainty.
(e) The Strategic Plan.
(f) Operating Plans—for each corporate activity area.
(g) Personnel Plan.
(h) Financial Plan.
(i) Standardisation of typing, etc.

Part 4. The Annual Planning System

(a) Relation with Long-range Plans.
(b) Relation with budgetary control system.
(c) Departmental Plans.
(d) Profit Centre Plans.

Part 5: Project Plans

Methods of evaluating capital expenditure proposals.

Part 6: Monitoring and Controlling Plans

(a) Annual Plans.
(b) Long-range Plans.
(c) Project Plans.

Part 7: Contingency Plans

* *Note:* There are a number of published papers re-prints of which would provide one way of dealing with this point. Recommended are:

"The how and why of strategic planning", by D. E. Hussey, *Business*, January 1967.
"Corporate planning", by K. E. Lander, *The Consulting Engineer*, December 1968.
"Corporate planning—a chairman's guide", by D. Hargreaves, *Long Range Planning*, March 1969.

own way. So long as all points are covered, it does not really matter in which order the manager records them.

A sensible system of control, and of standards of performance, will also help to make plans worthwhile, especially if the chief executive lets it be known that planning ability is one of the factors against which he measures a manager's success.

Over all, the planner must resist the temptation to be pedantic, or to collect data which are only of academic interest. Attention to the appearance of plans might reveal a professionalism which is to be encouraged, so long as it is remembered that good prose and pretty diagrams are the means not the end. A gold plating does not change the characteristics of a base metal, and some base metals are not worth plating. In marketing research there is always the danger of the researcher becoming hypnotised by his own project, so that he spends money finding facts which are of interest to him, but which do not contribute one iota to the solution of the marketing problems he is studying. A first-rate researcher guards against this; I think a planner has to beware of a similar tendency. A good plan will never be cluttered with trivia.

The planner must always remember that not all operating managers have the literary skill to write a plan as he would present it. Again, it should be stressed that it is the thought content of the plan which is important.

If there is any overriding message about planning, it is that the processes evolved must have a certain flexibility, so that they do not break at the first crisis.

CHAPTER 3

OBJECTIVES, GOALS AND STANDARDS OF PERFORMANCE

The Meaning of Objectives

One of the difficulties of writing about a process of management is that many of the words which form the vocabulary of management are hopelessly overworked. Words of common usage have been taken and given a specific meaning by different authors: unfortunately they have not all given the same interpretation. The result is a problem in semantics, which can act as a barrier to communication and to a common understanding.

Corporate planning is no exception to this rule, and one of its most used terms "objectives" has as many interpretations as there are planners. The differences in meaning are not always readily apparent, since they frequently have some common element.

Objectives are the general reason for the company's long-term existence: they are what the company is trying to achieve: they are the targets for strategic decisions.

The views of some other authors should be considered. H. Igor Ansoff (*Corporate Strategy*, McGraw Hill, 1965) states:†

> Objectives are decision rules which enable management to guide and measure the firm's performance towards its purpose.
> . . . something fundamental to the nature of a company and which distinguishes it from other types of organisation: it is therefore something permanent and

John Argenti (*Corporate Planning, A Practical Guide*, Allen & Unwin, 1968) defines an objective as:‡

† From *Corporate Strategy*, by H. Igor Ansoff. Copyright McGraw Hill, 1965. Used with permission of the McGraw Hill Book Company.

‡ Quoted with the permission of Dow Jones–Irwin, Inc., also, who hold the United State's rights.

> unalterable. It is the reason for the very existence of the company, that for which it came into being and, what it is for now. It is that which, if the company fails to achieve it, the company itself fails. It is a permanent unalterable purpose, or raison d'être.

Brian W. Scott (*Long Range Planning in American Industry*, American Management Association, 1965)† suggests that:

> Objectives here are the statements of planning purpose developed within any kind of business plan. They are established within the framework of a planning process, and they normally evolve from tentative and vague ideas to more specific declarations of purpose. Objectives, furthermore, are always present in a planning process even though they are sometimes unconsciously established.

From the varying definitions there emerges something of the flavour of corporate objectives (although it is only fair to add that further reading of the quoted works would reveal differences of opinion over what constitutes an objective: this does not matter, for we have established a common ground from which to begin our own consideration of the problem). Objectives are something to aim at, although they should be regarded as a map grid reference rather than as a target at the rifle range. The company will not always find that the shortest distance is a straight line, and may have to make detours to avoid obstacles. But having made the detour it is possible to come back to the grid reference from another direction. Without a defined objective it becomes very difficult to measure progress: having detoured, the company is likely to remain pointed in the wrong direction.

Objectives may be regarded, when used in the appropriate manner, as the beacon which on a dark night welcomes the fishing fleet into the safety of the harbour: used badly they can become the sweet singing sirens which lure the unsuspecting vessel to founder on the rocks of disaster.

I think it is fair comment to say that many companies do not have clearly established objectives. As Scott points out, they must *have* objectives, even if these are undefined. A problem comes through the variations in perception of these by the different managers in the company. Often questioning will reveal that this difference is often greater than a problem of emphasis: sometimes it means that different managers are pulling in completely opposite directions.

From a management point of view it is obviously better if all members of the company at least know what the company's purpose is. This is a problem

† Reprinted by permission of the publishers from *Long Range Planning in American Industry*, by Brian W. Scott © 1965 by the American Management Association Inc.

of communications. But having obtained a common ground of understanding, the chief executive now has a tool which he can use to motivate his managers. Apart from the feeling of pulling together and playing a key part which objectives can generate in a manager, they can be used to provide a standard against which to measure performance.

I mentioned that objectives can be a danger. This occurs when the wrong target is set, and the company is taken away from the course which would yield the best results. In other words, the company works to the wrong map grid reference, and ends up not in a land flowing with milk and honey, but in a barren plain. So getting objectives right is a very important part of the chief executive's task.

One of the dangers he must avoid is dealing in delusions. It is very comforting, and usually quite meaningless, to define corporate objectives in noble sounding but empty phrases: to deal in platitudes, rather than fact: to use words which leave a pleasant, warm feeling, but which are in fact a lie. Corporate objectives, unfortunately, when they are stated are often written in these terms. It may sound very public spirited to claim that the company exists for the benefit of its employees or its customers, but unless the company means to live up to these ideals it can only do harm by so stating them. Self-delusion is no help in long-range planning.

It will be fairly obvious that company objectives are not to be reconciled with the statement of purpose that every company incorporates in its Memorandum of Association when registering as a limited company. This is usually a legal form of words dreamed up to cover every likely activity which the company might at some time wish to indulge in. Objectives for long-range planning must channel the company's thoughts along much closer defined lines.

Peter Drucker (*The Practice of Management*, Heinemann, 1955) stresses that there is not just *one* objective for a company. To search for this is rather like the vain quest for the philosophers' stone, which turns lead into gold. There are many objectives, and these should be expressed to cover every key area of the company. In this he differs from Argenti (*Corporate Planning, A Practical Guide*) who believes that there is only one objective and this is profits, defined to a formula which includes both growth and return to shareholders.

My interpretation is that "objectives" is a generic term, which embraces a fairly wide range of targets of various types. I hold profits to be a key part of this family of objectives. Figure 6 provides an illustration of objectives seen in

this context, and it will be noticed that besides the different types, there are varying levels of objective. This means that the concept can be taken into every area of the company, and can be used as a method of motivation and control.

Before the components of Fig. 6 are discussed in detail, some attention should be paid to constraints. These are things that for moral or ethical grounds the company will not do, despite the fact that to do them would put the company a long way towards the achievement of its objectives. In this, I do not include the patently illegal, and make the assumption that all companies are attempting to act within the law: at least no chief executive sensible enough to attempt corporate planning would leave written evidence of his intention to break the law! Constraints should be written, because it is just as important for all managers to be fully aware of the things they may not do, as it is for them to know the target for which they are aiming. One constraint which some companies have been known to practise is the refusal to borrow money: this naturally affects their capacity to earn profits.

Primary Objective

The first component of the family of objectives is the profit target, or primary objective. Profit must be the prime motivation for all companies, except those who are formed as a charity or similar purpose. Many managers will argue that their objective is to maximise profits. The only problems with this definition are that nobody knows what it really means, and there is no method of telling when it has been achieved. In most cases it also happens to be untrue: no company is prepared to do *anything* for profit—for example, some companies may hold that profits connected with the betting industry are immoral, and few would now insist on working their employees into a state of complete physical and mental exhaustion. In dealings with their customers, most companies are likely to argue that they must act in such a way that the customer is likely to repeat purchases in the future, as they are not looking for high profits that end with the first order, but a source of profits stretching out to some future time horizon. So the definition that "our objective is to maximise profits over the long term" is coined.

Unfortunately, this too is meaningless.

Some companies express their target in terms of a return on investment ratio. Unless this is linked to a specific figure of required profits this is a poor objective. R.O.I. can be maintained while profits shrink, if capital is reduced by the reduction of debtors or inventories, or by the normal process of

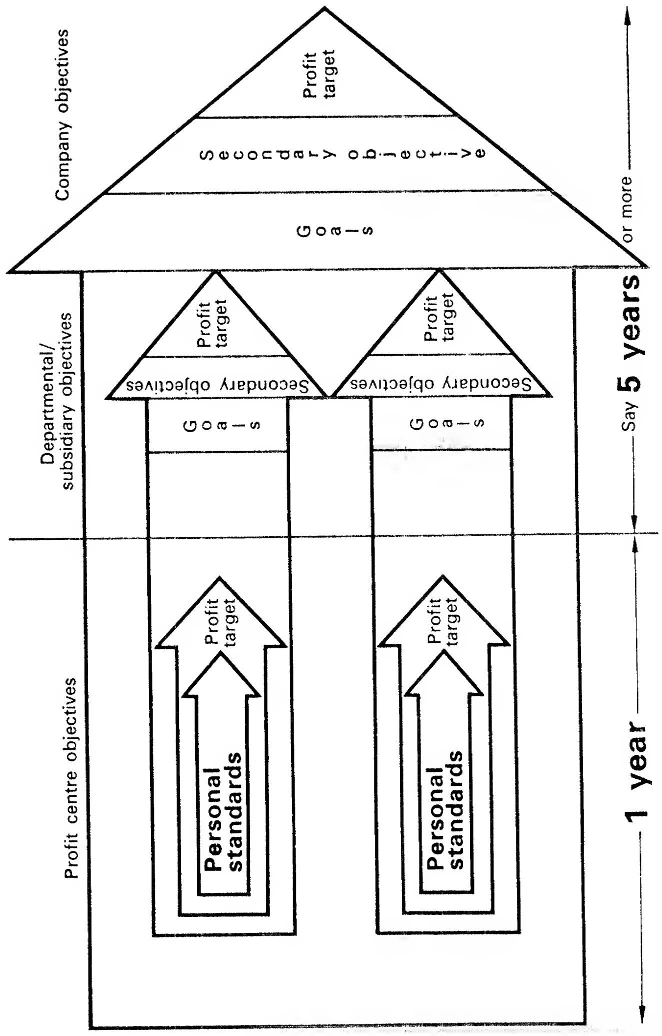


Fig. 7. A system of objectives.

depreciation. A shrinking target is hardly likely to appeal to the owners of the business!

Return on investment itself can be a mixture of numerous items. Assets may be in the books at various values: at original purchase price, at a revaluation, or depreciated. What the accountants call goodwill—when the acquisition of a business costs more than the value of its assets—may or may not have been written off. I do not believe that this renders the concept of return on investment meaningless, provided the company sets itself a series of house rules to work to. This means that the capital employed figures may differ from those in the books: for instance, I think there is a good argument for not writing off goodwill in the management control figures. Having set its rules, the company has one of the parameters of its profit target.

In fact this parameter should be defined and expressed in two ways. From the management viewpoint, return on capital employed provides a criteria of effectiveness. The shareholder is more interested in a return on equity capital, and this must also be taken into account. Return on shareholders' capital could drop because of a change in gearing, even though profits were rising: this would affect the dividend earnings per share, which in turn could cause changes in stock market prices.

The second element of the target is a rate of profit growth, on a defined base. So the target might be expressed in terms like these:

> The target for the next 5 years is an annual growth of after tax profits of 5%, provided that a minimum return on capital employed of 10% is maintained.

This shows the sort of target that can be established, but we still have to think about the things a company might consider to arrive at these figures. Whatever target is set has to satisfy the people who own the business. So one guide-line that should be taken is the return and growth rate which the company has achieved in previous years. This provides a base line. Now if this is below the performance of other similar companies—and we must accept that it is difficult to find exactly comparable data, so any results will be approximate—the chief executive may feel that he is setting his sights too low, and may upgrade his target. The chief executive may decide that even this improved target is not good enough, and that he must increase above this. Whatever target he sets, he will want to review it in the light of the corporate appraisal, to make sure that it is neither below nor above the capacity of the firm.

One thing he can never do with impunity is to set targets which reflect a worsening of performance. Shareholders do not like to take cuts in their dividend!

In recent years the use of a profit objective expressed in growth in earnings per share has found considerable favour. This has the advantage of relating profits to the shareholders' stake in the company. It could lead to financial policies based on loan finance rather than risking reducing the earnings per share by increasing the number of shares. Overall it is a good measure.

The company profit target must eventually be broken down into targets for each division (or subsidiary) of the company, and for each profit centre. The chief executive should not make the mistake of setting the same growth and return on capital employed targets for each division. One area of the company may yield a 30% R.O.I., another may struggle to make 10%. One may have fast growth profits: another may be in a mature market. These varying returns may reflect the differing degrees of risk attached to each business area. It may be very wise to have a low yielding sector of the company, which can be guaranteed to turn in a certain level of profits, and seeking to achieve the total company target through a balance with high yield, but higher risk, projects. But this is moving into the realms of strategy.

Profit centre targets are probably best set by the division controlling them. It may be that only yearly targets are required at this level. It is also possible that a further modification of the R.O.I. concept is desirable. For example, a company might operate three shops of identical size, yielding about the same profit. If one was purchased in 1930, another in 1968, and the third is rented, there will be a completely different capital employed structure. It would be necessary for the manager of the 1968 shop to be four or five times as efficient as the other managers, in order to obtain the same R.O.I. What may be a better motivating target is one which is adjusted for these differences—perhaps all buildings valued on a 1968 basis (including the rented one), and earning adjusted by a rent/depreciation factor. The reasoning is not, of course, to make the task of the manager of the 1968 shop easier—he must still yield an R.O.I. acceptable to the company! It is to upgrade the targets of the other managers in a fair way. Inflation accounting would go a long way in helping to set these targets.

These specified profit targets at company and intra-company levels are an essential part of any system of objectives. They are not in the least vague, and are measurable.

Concentration on profit to the exclusion of all other factors is likely to be

harmful to the company, and there are other objectives of at least equal importance.

Secondary Objectives

The next group of objectives (for want of a better description) may be termed secondary objectives. This is not to suggest that they are inferior or in any way less important than the profit target. Both concepts are required if the company's system of objectives is to be a truly motivating force.

At the total company level the secondary objective is a description of the nature of the company's business (the term "mission" is used in some books). First the question "What is my business?" should be asked. (This is established in the corporate appraisal, although a preliminary definition can be made beforehand.) This is not the objective, which is revealed by the answer to the next important question to be asked "What should my business be?"

This particular concept is, therefore, the definition in as concise a way as possible of the type of company the chief executive intends to have at some future date.

Those who criticise this approach argue that a definition such as this really falls into the realm of corporate strategy. There is truth in this, but there is a counter argument. Firstly, it does not matter anyway if the concept does trespass a little, because none of the steps in the planning process are completely isolated from the others, and indeed, each overlaps every other one to a certain extent.

The second argument is even more powerful. There is a concept of what a company should be in the minds of every chief executive, regardless of his strategy. For example, there is a very real difference in corporate purpose between a conglomerate company which is willing to make an investment in any field, provided it is profitable, and a company operating in one or two industries which would never consider moving into a new area. It may be that the day will come when the second company will have to change its objectives, but this in itself is not wrong. There is a similarity with the objectives of a person as he matures. As he gains in experience and education, as he obtains family and other responsibilities, so his concept of his ultimate aims changes. So it is with a company. There is no reason to expect any targets set today to be the right ones for the next hundred years—and this applies to the profit targets as well.

Of course it is important for an objective to be stated in terms that lead the company in the right direction. Too narrow a definition can be stilting–the wrong map grid reference mentioned earlier. A company supplying coal might put itself in a straight-jacket if it saw its business as simply the "supply of coal to households". A broader definition "The corporate objective is the marketing and distribution of home fuel requirements" might help the chief executive to see opportunities in the sale of paraffin or domestic fuel oil–or of marketing his fuel through untraditional channels, such as the pre-packed solid fuel now passing through greengrocers.

This looks very obvious, and the immediate reaction might be that the coal merchant might see this as his business without being so specific. There are many examples where management within narrow limits of vision has lost many opportunities to a company. For many years the railway undertakings saw themselves simply as being enterprises engaged in the running of trains, rather than in the physical distribution business. Some shipping companies might now consider that they are as much in the hotel and entertainment business (luxury cruises, for example), as in the activity of transporting goods and passengers from A to B. Perhaps some grocery wholesalers who once had a conception of themselves as warehouse operators, transporters, and sellers to retailers, now consider their main task is to help retailers who deal with them to make a profit. This must be one driving force in the voluntary chain movement.

This sort of objective can be used as a motivating agent, to help management to see the opportunities, and to stretch their vision. Once people are thinking on the right lines it becomes less easy to overlook the obvious. Many of the improvements in the way a particular company is run are so often obvious–but only after they are pointed out.

Other types of objective should also be set, to cover each of the key sectors of total company performance. A small family of secondary objectives will be formed. Examples of other areas where further definition may be required are in relations with company personnel, with government, perhaps even to such items as the type of corporate image the chief executive intends his company to have.

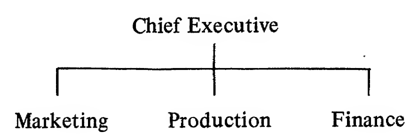
These statements should be as specific as possible (quantification is a good rule to follow, and even the objective for the corporate image can be quantified), and above all they must be true statements of intent. If the company does not consider any particular aspect important, it should not

frame an objective to cover it. The example above of relations with government is a case in point. Some companies hold to the principle of being "good citizens" of every country in which they operate. This policy can have a far-reach effect on their operations. That great American giant Union Carbide takes relations with government so seriously that it has set up a special department to foster contact and co-operation. Other companies have no such policy, and may feel that they do not wish to obtain any particular relationship with government—only to stay within the letter of the law.

The modern tendency is for companies to acknowledge that they have a plurality of "stakeholders", employees, shareholders, the community, customers and suppliers all of whom have expectations from the company. Objectives need to be defined in each area. The shareholders are no longer the only important influence on the aims and behaviour of the firm.

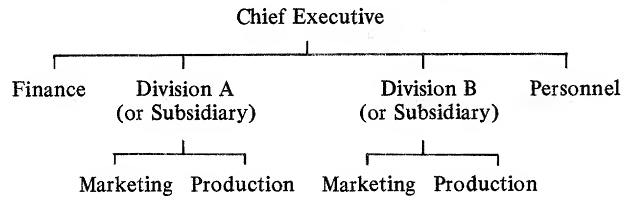
The concept of secondary objectives goes further. Once the total company objectives are set it is desirable to examine the purpose of each subsidiary company or department, and to set objectives in a similar way for each of these. A company organised on simple lines, as in Fig. 8, might have one level of such objectives to cover each of the functions in the second level of management.

Fig. 8. Company organised on simple lines



A more complex company, as in Fig. 9, could well have one level of objectives for each division or subsidiary which are similar in scope to the overall corporate objectives, and to which the same principles apply, and a further level, similar to those of the "simple" company, for each function within the divisions.

Fig. 9. Company organised on more complex lines



Many of these objectives do fall right under the heading of strategy, since they can only be determined in areas of the strategic decisions.

Goals

The objectives discussed so far are all long term. The next family of objectives, goals, stretches over the whole time span of the planning period and is related to a stated date within that time span.

Goals are quantified objectives that provide a unit of measurement, from which the chief executive can confirm that his strategies have been carried out. This means that they can only be set *after* strategy has been decided. They are, therefore, a very different type of objective from the profit target which is determined *before* strategy is formulated. It is important to understand this difference. The primary objective, and certain of the secondary ones, are the map grid references that show the corporate target: the goals are the landmarks and milestones which mark the selected path the company is to take to reach the reference point. There is a simile with an explorer who knows where he wants to get to, and has the choice of several alternative routes that will take him there (just as the company has the choice of various strategies), one of which is better than the others. He will want to make sure that he is on the right track and will identify landmarks that he has to pass by a certain time: on day two he should have reached a range of mountains, by day three he must cross a wide river, day eight will see him on the edge of a desert which will take him 2 days to cross. In a similar way the company will have to predetermine the points it should pass by various key dates.

What form should these corporate landmarks take? The principle is that there should be quantitative targets for every important part of company

operations. There should be as many goals as it is practical to develop. The only constraint is that it must be possible to measure results so that progress can be judged. There is little point in putting a number to something that the company either has no intention of measuring (or finds impossible to measure). The preferred targets are those against which results can be measured as a matter of routine from the company's information sources, whether these be accounting, marketing research, or personnel records: goals which require a special exercise in order that results can be compared can be worthwhile, if the costs of the exercise are not too high relative to the benefits.

So a goal might be:

* A percentage share of a defined market (or segment of market).
* A ratio such as return on sales.
* An absolute figure for sales.
* A minimum figure for customer complaints.
* A maximum figure for hours lost in industrial disputes.
* An accounting figure such as a liquidity ratio.
* Employment figures.
* Number of resignations as a percentage of total employees (the idea being to keep below this figure).
* The ratio of training grant to be obtained against contributions to an industrial training board.
* A value for operational profit improvement.

Another type of goal is a time-table. What so often happens when a plan is written is that there are missing pieces of information: a strategy may have to be evaluated in a test market; a special study may be needed of the benefits of relocating a plant: the list is endless, because the process of planning forces managers to find these gaps in their knowledge. In this type of problem, the goal would be the date by which the missing data are to be obtained, and the name of the person charged with carrying out the task. It goes without saying that results can be easily measured.

All of these goals can be expressed for different time periods. The time-tables are self-extinguishing: a market share goal might be expressed as a permanent target, or there could be a different target for every year of the plan. And goals can be established at both the total company level and for subsidiaries, departments and divisions.

What emerges is a network of targets of varying degrees of importance

which with the profit targets form a model of the company over the time span of the plan.

Standards of Performance

Over a shorter period, say for the first year of the plan and related to the more detailed annual plan and budgetary control system, it is possible to develop a concept of personal standards to measure the performance of the lower management levels, and certain other employees such as salesmen. The system described here has certain similarities with "management by objectives", but is not as comprehensive, nor does it require the participation of all of the people for whom standards are being set. If a more detailed system of standards is required, this can be found in Humble's *Improving Business Results* (McGraw Hill, 1968) which explains the concept of management by objectives. In my opinion the system of profit targets, secondary objectives and goals is fully compatible with Humble's method.

Standards of performance are really a logical development from the concept of goals. They can be used as a method of motivating a wide range of employees who are not directly responsible for the achievement of the goals, but whose personal performance will influence the company's success or failure. Not only do they motivate, but they provide a management tool which can be used to judge the success or failure of a person in his job. They provide an early warning system for when things are going wrong, and they can spotlight the area in which the failure is occurring. Standards can be set for much shorter intervals of time than goals: there may, for example, be a monthly standard.

As with goals, performance standards must be for something which the company intends to measure, and which it can in fact measure. The standards can be established for any sector of the company, and should be set for the key areas.

They make most sense when they are directly related to the annual plan of a cost centre or profit centre. At this level it is possible to calculate the standards so that the contribution of each to the budget of the centre is taken into account. For example, for a salesman the following types of standards might be set which, in the judgement of the manager of the profit centre, must be fulfilled if the centre is to achieve its planned results:

* Total sales required.
* Sales standard for particular products.

* Number of new customers to be obtained.
* Customer call frequency.
* Minimum sales level to which small customers are to be upgraded.
* Maximum number of customer complaints.
* An average cost per customer call.

For a warehouse manager it might be possible to set for the operations under his control:

* Maximum number of hours overtime to be worked.
* Man-hour standards for various tasks.
* Standards for maximum amount of wastage or breakage.
* A standard for stock loss.
* Cost standards for various sections of his operation.
* Maximum number of employees on strength at any one time.
* Weight tolerance for repacking and packing operations.
* Frequency scales are to be checked.

It is important to make standards realistic. If the business has a seasonal pattern, the standards set must follow that pattern. For example, in the motor car spares business there is a peak sales period in summer and a small peak around Christmas. It would be sensible for sales performance standards to be constructed to this pattern (as indeed the monthly budget should): simple division of annual sales by twelve would produce no worthwhile standards.

It is, of course, a prerequisite that job descriptions are issued in writing to those persons who are set standards of performance. They must be in no confusion over what their duties are.

Total Concept of Objectives

This total concept of objectives is a comprehensive and meaningful one. It is a little untidy in that some types of objectives are decided very early in the planning process, while others only fall into place as plans are completed. The merit of it is that all the parts do fall into place, and that there is a relationship between the standard of performance set a salesman and the total corporate profit target. It is right that this connection should be emphasized, because if the salesman (or personnel man, or production supervisor, or any other such person) does not do his job properly, the chances of reaching the profit target may be reduced.

The total concept also has the merit of answering the criticisms of other types of objective which have been raised at various points in this chapter. It is a flexible system. Above all, it gives all levels of management a means of control, which is so important in making sure that all planning does lead to meaningful action.

CHAPTER 4

THE CORPORATE APPRAISAL

Because corporate planning is a relatively new subject—and one which has fired the imagination of managers of all types—there has been a tendency for much of the published material to concentrate on the most exciting aspect of planning activity. The assessment of company strengths and weaknesses is rarely given any treatment in depth, and this has led to the neglect of this vital step in the planning process by many companies installing their first planning system.

Many managers tend to equate corporate planning with the rather more romantic elements of long-range strategy: acquisitions, mergers, and major capital expenditure projects. But before strategy reaches this stage there is a good deal of hard work to be undertaken—at the end of which it may be decided that the company's path to greater profits may lie in improving present operations, rather than embarking on something new. This chapter is about some of that hard work.

Good long-range planning begins with the present, with an objective analysis of a company's strengths and weaknesses, and with decisions on the action that should be taken to correct those factors which inhibit the company's long-term profitability. This stage might well be called establishing the corporate identity, for only by fully defining the factors that make up the company can the planner assist in setting it on the best path.

Perhaps this can be compared with the task of a career counsellor. It is relatively easy to make a list of jobs available to a young man or woman, just as it is simple to produce a superficial list of investment opportunities open to a company. With the career counsellor the real skill comes in taking stock of each applicant, examining his qualifications, his personality and temperament, defining the areas in which some sort of further development may be required (for example, training), and matching these characteristics and the applicant's aspirations against the various options open to him. There are

well-established techniques that can be used to find out most of what needs to be known about a person. Digging deep into the psyche of a company is a more complex operation, but no less important. Failure by the company in this area can be as stunting to future development in the corporate sense as can the misplacement of a school-leaver in the personal sense.

But how can a company set about establishing its corporate identity? What should it seek to find out about itself?

Every chief executive has some idea of what his company is best at, and what it is worst at. Unless he has devoted special efforts to this problem, it is likely that he will not know as much as he thinks he does. The larger the organisation, the harder it becomes to know everything, and even in the smallest company, unless a formal analysis has been made of each area, the chances are that some things the company does will be the result of history rather than a decision that these things are right. The basic questions that should be asked are:

What are we doing now?
Why are we doing that?
Are there any alternative ways?
Should we be using these?

The study should lead to action. Immediate benefits can come from profit improvement schemes that will be suggested by the study—and it is well known that improvements frequently yield a higher return on investment than the best capital projects. Identification of weaknesses—which may be serious limiting factors to the company's long-range plans—is the first step towards their removal. Obviously not all weaknesses are correctable, and there are some that every company has to live with—but knowledge of these means that the company can avoid decisions which put strain on areas that cannot withstand it. Some weaknesses can only be removed over a period of time—ways of doing this should be built into the long-range plan.

A corollary is that the company will also identify its strong areas. The object of this is not to flatter management ego, but to show some of the areas on which the company should concentrate its future efforts. Building on corporate strengths may be something of a hackneyed phrase, but it is one which has a lot of truth in it.

As a by-product of the study, opportunities may be identified for future expansion and development that would otherwise not have become apparent.

The basic aim of long-range planning must be to increase profits. The chief

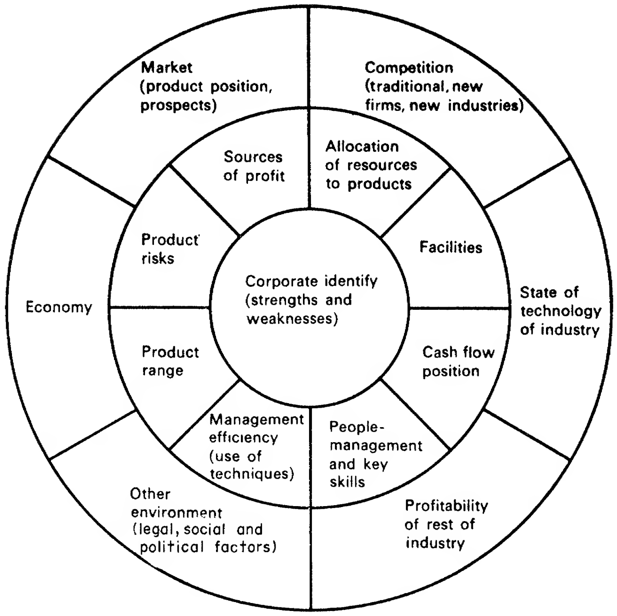


Fig. 10. The appraisal of the company's strengths and weaknesses.

executive who begins his planning with this sort of study is more likely to achieve greater success than his competitor who develops his plans in a vacuum.

How should such an evaluation be carried out?

For ease of discussion the evaluation can be considered under two major headings: internal and external. In reality the two areas combine to provide a single answer—for instance, there may be little purpose in making production changes to a product unless it has market acceptance.

Internal Elements

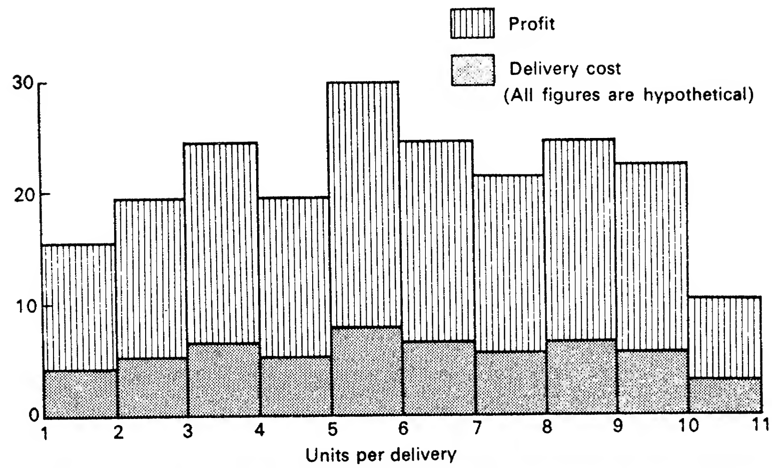
Perhaps the best place to start with is the identification of the profit contribution of each area. What percentage of profits comes from where? The study should be made first by profit centres and then broken down by product. Of course, many companies will have these data as part of the normal

management information system—although the remarks later in this chapter about the basis of cost allocation may be relevant. Having identified the profit strength of each product, it is wise to study past trends and internal opinions about the future prospects of each product. If, for example, the major contributors show signs of slipping, this should be known. By this stage the company should have an opinion of its present and future "bread-winners".

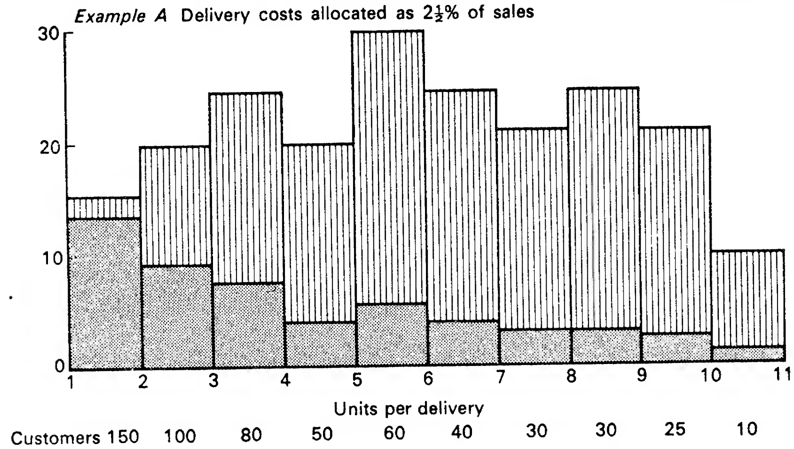
The next step is very important. This is to examine the allocation of resources between products: not only resources of money and plant, but also the perhaps scarcer resources of management talent and technical skills. What so often happens is that a declining product area is given to the best people to manage "to put it on its feet", when potentially more rewarding areas are not fully exploited because they are left to the second and third grades of management talent. This sort of analysis may show that R & D effort is misplaced. One so often sees in a company a prestige division which gets all the plums of personnel and finance because of its past glories, while other divisions with far greater potential have to take second place. The sort of decision that should come out of this analysis is where to change the emphasis. The wise investigator will also wish to examine the risks attached to each product. For instance:

* How much dependence is there on one supplier for each type of raw material?
* How much dependence is there on one or two customers for most of sales?
* What happens to the product if one key person leaves (e.g. a designer in a fashion clothing business)?

Many companies take pride in their wide product range. The size of this is a fertile field for study since every additional product brings increases to inventories, clerical costs, and frequently to production costs. It is well worthwhile considering the savings that can take place from a reduction in the range. Expressing these potential savings in money terms gives an incentive to take action. In this analysis every pack should be considered as a product. The aim should be to remove all products with inadequate contribution (or potential) to profits, and to reduce the other products offered by making one do the work of several.



Example A Delivery costs allocated as 2½% of sales

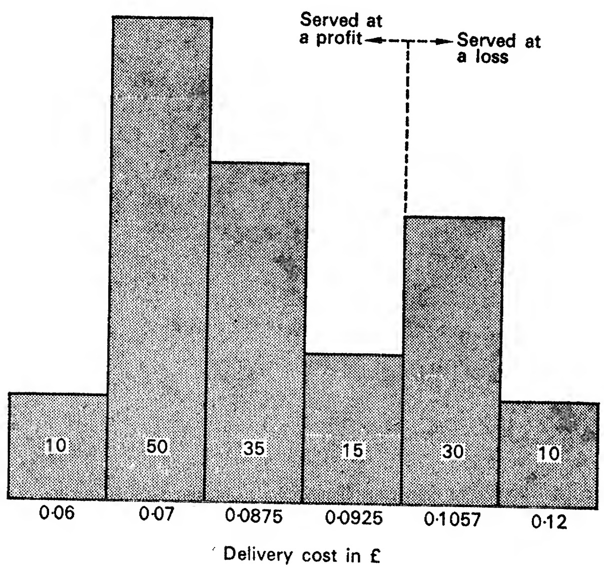


Example B Delivery costs allocated at average call rate (£0·0914/call)

Both charts show contribution to delivery costs and profit

Note. **Actual costs will not fit either pattern, although *Example B* is more accurate than *Example A*. A time study would show that the cost of delivering 10 units is more than the cost of delivering 1 unit—but perhaps only twice as much. More important, actual cost would fluctuate round the norm for each group, because of distances and other customer differences.**
Implications for policy are that many customers in the lower ranges will be served at a loss.

Example C Number of customers and actual cost of serving



Note. Actual average cost of serving each of the 150 customers in the "over 1 but under 2 units" category is £0·0875 per call.

Fig. 11. The realistic allocation of costs.

In all the steps outlined so far, the cost added to the product by the business is of vital importance. In many cases the apportionment of costs between products is on some form of allocation basis. Now it is worthwhile studying the basis of allocation since although suitable for many purposes it may be inadequate for this study. Many allocations assume that costs fall in a normal distribution; for example, that invoicing costs are a fixed percentage for all products. Inventories may be treated on the same basis. If costs are reallocated on the basis of actual transactions two things may become apparent:

* a skewed distribution between products;
* a skewed distribution between different customers.

An example may make this clearer (Fig. 11). A firm offering a lorry sales service is likely to express its sales/delivery costs as a percentage of the sales value—say 5%. The assumption is made that every £1 of sales bears the same percentage of cost—in other words that a normal distribution applies. In fact, everybody really knows that it costs less per unit to sell one customer 100 units than to sell 100 customers one unit each. In addition everybody knows that it takes more time and effort to reach a customer 10 miles away than one who is only 1 mile away. In other words costs do not fall in a normal distribution. Yet few companies organise their cost data so that they can make any decisions on this basis. The sort of decisions that have been made by companies applying this sort of analysis are:

* removal of service from many very small customers by a national distribution concern—resulting in a 20% cut in lorry fleet size, no loss of turnover because of the ability to concentrate efforts on a smaller area, and a substantial increase in profits;
* the charging of a minimum price of £5 per order by an electronics company, forcing small customers to wholesalers;
* charging small orders at a considerably higher rate by a quarrying company to take account of the extra costs incurred.

So far most of the discussion has been about the company's products. Some attention should be given to resources. Firstly, an assessment should be made of the company's production facilities. Are they efficient? Is there surplus capacity? Is there room for expansion? Can two plants be rationalised under one roof? The list of questions can be increased.

One thing every company is likely to know is its cash-flow position and its ability to raise money. At this stage a rough forecast of cash resources should be made, to give the company some guide-line along which to develop future strategies. If money is going to be a problem, the company's freedom of choice may be restricted. In such circumstances it may be important for the company to examine its credit policies, and vital for it to find ways of reducing capital tied up in inventories.

But money and plant are not the only ingredients of a successful business. Every company depends on people, and no company can afford to ignore this. The problem which is very much to the fore in many family businesses is top management succession. This is only one aspect, and the whole question of recruitment and development of people should be studied. If the company has difficulty in attracting the right people there must be a reason—and there

is little hope of improvement until this reason is identified. A careful stock should be taken of the ability of each key man—after all there is little point in launching new products if you know your marketing manager is not capable of making them profitable. As in all other points discussed, clear strategies should emerge to correct the position. Few companies can sack their total staff merely to replace them with better ones, and every chief executive has to manage with the human material he has in the company. But this does not mean that a bad situation has to be accepted, as positive action can be taken in the fields of training, recruitment, organisation and redeployment of people.

The planner should also be aware of the management techniques used within the company, the extent of their utilisation, and the available techniques not at present being applied. By this I am not advocating the pinning of all hopes on the latest management fad, but on acceptance of the fact that present methods are not necessarily the best ones.

External Elements

The consideration of internal evidence is only half of the picture, and will not yield the best results unless attention is given to the world outside the company. Because no company can make profits without customers, the analysis should begin with the market-place.

Firstly, the company should find out what market position each of its major products holds in the market, or more important, in each segment of the market. With some products, or with smaller companies, the expression of this position as a percentage market share may be difficult, but great precision is rarely needed: what is essential is a fair idea of the standing of each product in the market, compared with the standing of competitive products, together with an appreciation of the potential for growth within the market. The company should define why its products hold the position they do: what is special about them that makes people give them preference?

Much may be learned from the sales force, although there is frequently a bias in data obtained from this source. A complete appreciation will probably require marketing research, and in this case should investigate the image of the company, as well as the market for its products. The smaller company should not shrug off marketing research as too costly. Useful data can often be obtained from desk research (a study of published data) and can be supplemented by qualitative research. The combination of the two, which

need not be expensive, may give the insight needed without incurring the cost of major surveys. The channels of distribution should be included in the study, for it should be remembered that the channels used by the company will in many cases not be the only ones possible.

The company should be sure that it understands its markets: that it knows what the consumer requires and whether this requirement is being satisfied.

Naturally, competitive activity should also be studied, and an attempt should be made to define the strengths and weaknesses of each competitor. The danger here is lack of objectivity by those carrying out the study, for it is too easy to under-estimate the competition, and a manager's knowledge of competitors can never be as perfect as his knowledge of his own operations.

Potential competition from new entrants to the industry should be considered. An industry which requires little capital or technical knowledge is always more vulnerable than one which is more difficult to enter. In this particular part of the investigation it is the degree of risk that has to be assessed.

One area of competition that is most important and most difficult to study is that coming from outside the traditional industry. The company must assess the vulnerability of its main products to substitutes, since unless it does this it may one day find itself in grave difficulties. It is significant that so many substitutes are developed by other industries—in the past we have seen plastic take over much from paper, cement roof tiles replace clay tiles, and synthetic fibres attacking the province of natural fibres. The process will continue, since it is part of a developing technology, and if I were in the textile industry I would be taking an interest in the new process announced by a chemical company to make the industry obsolete. Similarly the development of the electric car from sources outside the present motor industry is likely to affect vehicle manufacturers, the vehicle distribution trade, and service stations. There is no easy solution. Each company must keep continuously aware of new developments and must always look out for this sort of opportunity from its own research work and from its studies of consumer need. In my opinion the acceptance that things can change, and the freeing of the thoughts of those in the company to deliberately seek this change, is half the battle. At this stage in planning the company is attempting to establish the *status quo*, for this is the first step to meeting change as an opportunity rather than as a threat.

Effectively this is one aspect of examining the impact of technological change on the business. Equally important is the way in which process

changes can affect manufacturing methods, economics and the use of raw materials. Materials, too, can also be affected by substitution.

Every company is affected by the economies of the countries in which it operates, but not all companies mirror the ups and downs of the trade cycle. Inflation is a major change agent, because it consists of composite factors which affect social behaviour, markets, costs and competitive position, and has a profound effect on cash flow. Exchange fluctuations may be critical.

The effect of economic changes in the company must be identified, since without this it is difficult to assess the vulnerability of future profits. No companies have the individual power to make major changes to the course of the economy (except possibly in under-developed countries), but all can alter their own balance of risks by diversification of product or geographical area.

Economic change in recent times has probably had a greater impact on business than technological change. Of even greater significance are social factors, which are closely linked to political and legal issues. Social values and expectations have changed dramatically since the Second World War, and continue to change. Not only does this alter the business environment in which the organisation operates, but it also modifies markets and creates new problems of the management of people. In the sphere of industrial relations it is clear that management faces the task of balancing a "plural society". An organisation is not made up of people united in aims, ambitions and values who can be exhorted to play the game. The way in which different pressures outside the company are likely to develop and affect the behaviour of its employees is a critical area for study.

The performance of other companies in the same industry should be studied. The lucky firms (in the U.K.) will be able to participate in a study by the Centre for Interfirm Comparisons: others will have to rely on the published accounts and public announcements of competitors. As with the other points discussed, the objective is to assess the reason for variances—not just to establish that they exist.

Also of vital interest is an assessment of the company's vulnerability to take-over. To make this, the investigator should look at its own record, financial policies and balance sheet, against the background of activity in the market. Of course if the company *wants* to be acquired, it may develop a strategy that makes it more attractive to the roving eye of the hunter.

The Combination of Elements

As listed above, the elements to be examined suggest a chain relationship,

with item neatly following item. Of course reality is not like this at all, and the key elements—and there are others which have not been discussed—have a sort of spider's web relationship, with a tangle of crossed lines but all with a central theme leading to a focal point: the uncovering of the corporate identity.

Fig. 12. Example: One method of summarising company strengths and weaknesses.

Part 1: Weaknesses/Limiting Factors

	Immediate Strategic Implications
1. Management	
(a) Chief executive aged 65, no obvious successor.	(a) Recruitment, merger, or sale of business.
(b) Weak middle management.	(b) Recruitment, training. (Position can be improved but some weakness will remain for 5 years).
(c) Marketing manager incapable of handling any expansion.	(c) A serious block. Solve by organisation change or replacement.
2. Marketing	
(a) 80 per cent of profits emanate from product A, market declining at 5 per cent p.a., market share constant.	(a) (i) Reduce dependence. (ii) Changed market strategy to improve performance. (iii) Cost reduction to improve position—introduce value analysis.
(b) 25 products contribute no profit and have no potential.	(b) Cease production, re-deploy resources.

Part 2: Strengths

1. People
   (a) A high level of technical expertise in production departments.
2. Marketing
   (a) Strong image among consumers, particularly for quality, performance and after-sales service.
   (b) Five established brand names.
3. Finance
   (a) £500,000 available for expansion from own resources. Up to £2 m loan capital can be raised without difficulty.

Note. All statements would be supported in the Report.

With the data obtained, it will be possible to write down a series of factual statements about the company, together with the strategic implications. How

these statements are formulated depends on the complexity of the company–and the personal approach of the investigator. (An example is given in Fig. 12.) It is important that they be written, since in most companies there are likely to be areas of dispute (in fact it is almost possible to say dogmatically that if everyone agrees with the report, the job has not been done properly), and emotions will be involved. It is much easier to make an objective decision if all the evidence is fully documented.

The reports may not always be pleasant. Few people enjoy trying to convince their chief executive that an area of the company which is dear to his heart should be closed down, or of similar unpopular measures. But this sort of study must be approached with integrity, for without a genuine attempt at honest appraisal the whole exercise may become a meaningless gesture.

Also important is the consideration of alternative strategies to build on what is discovered. There is little point in deciding that the bottom is about to drop out of your market, and then sitting back and watching it happen. There are no rewards for prophets.

The final report should show clearly the strong and weak points of the company. It should assess the vulnerability of the company to likely changes in the environment, and should establish what I like to call the company's "risk balance" (which put simply is the number of baskets the company has to keep its eggs in!). It is at this point that the company is ready to think seriously about its future profit targets, and the ways in which it will reach them.

This sort of evaluation is complex, but not too difficult to be completed by any competent executive. If the company has a corporate planner he should play a major part: indeed, in my opinion, the planner who does not attempt to define the company's strengths and weaknesses is not doing his job properly. I would recommend that a team approach be used, with people from line functions working with the planner. This goes to make for a greater involvement of operating management, and removes the feeling of imposition that may come from a purely staff investigation. In my view, this team-work approach should be used for other planning problems, as it acts against what I regard as a dangerous tendency to large planning departments. The fewer the staff people engaged in planning, the larger the contribution that line management will have to make–and this is where planning really belongs.

Some companies may feel that this sort of study is best tackled by consultants. This can, of course, help to ensure greater objectivity, but I

would regard it as an optional method of approach, and by no means essential. It is probably more likely to be advisable when a corporate planner is appointed from within the organisation.

What has been discussed in this chapter is nothing more than a function of good management, and many may feel a defensive pride in their own way of running the company. Some companies may indeed already have much of the information available in different parts of the company. What is so often lacking is the drawing of all important data together to present the complete picture. The management casebooks are littered with the testimony of companies that found that they did not have as perfect a knowledge of themselves as they once thought.

Of course this sort of analysis is not restricted to companies that practise long-range planning. But the company that does it will suddenly realise that it is half-way to knowing what long-range planning is all about—the way to better profits.

CHAPTER 5

RISK AND UNCERTAINTY

One of the objects of corporate long-range planning is the reduction of risk: not the removal of risk, since this is impossible because the future will always be uncertain and will always contain elements of the unknown and the unforeseeable. But any reduction of the odds against a company is worthwhile, if achieved at reasonable cost.

The fact that a company is giving thought to its future, and is attempting to plan, will by itself remove some degrees of risk. The good planner can help his company to project a few rays of light into the darkness of time to come, and these will show up some of the pitfalls and obstacles—and, hopefully, will reflect on some of the opportunities—that lie in the company's path.

The formal planning process includes many ways of progressively defining, measuring and reducing risk, and this chapter is about some of those methods. The chapter is particularly applicable to the small to medium company, who may wish to use methods that do not involve the development of computer models. Most of the steps described are, of course, basic to all companies, whatever their size, and no matter how sophisticated their techniques of analysis.

Much of the chapter is about making assumptions on which to base plans, and using these assumptions to deal with this problem of risk. A brief look will be taken at company strategy and its relation to an uncertain future.

Assumptions

Every company that sets out to do long-range planning soon discovers that there are numerous items of information missing in its knowledge of things which affect its future. Few people claim to be able to operate a crystal ball, and at first sight the lack of a clairvoyant on the staff may make the task of planning appear impossible. How can the company, for example, know what

vital profit-reducing action will be taken by government, when even the government may not know? Every year, for which the planning horizon is extended, brings its own increase in uncertainty.

The situation need not be as chaotic as it seems, for assumptions can be substituted for the missing elements of knowledge. This means that plans can be based on a logical structure. But good assumptions can do more than make planning possible; they can assist in the assessment of some of the risks the company faces, and in many cases can lead to actions that would reduce or remove that risk.

An assumption may be defined as a statement of opinion about the occurrence of an event which is outside the control of the planner. This statement is treated as fact during the development of plans, although the judgement element must never be overlooked.

Assumptions are necessary for both strategic and operating plans. The definitions of these terms are worth re-stressing. To me the strategic plan is the master plan of the company, which sets the objectives and targets, and the broad means by which they will be achieved. An operational plan, on the other hand, is made by an existing section of the company within the framework set by the strategic plan: it shows how the department or division concerned intends to meet the goals set by the strategic plan.

Naturally all the relevant assumptions in the overall corporate strategy will be carried over to the detailed operational plans, but in addition an operating plan may have assumptions of its own. It would not be logical for the overall strategic plan to include the assumption that the marketing department has correctly calculated the financial outcome of its own plans: it would be correct for a production division to make such an assumption in its operating plan, where it has to take marketing figures as datum.

The initial reaction on some managers to the making of assumptions is why should they bother, as they haven't a hope of foretelling the future? The stock answer to this is that they are making assumptions even though they do not know it—usually that current events will continue. The tacit assumption is less likely to be correct than an assumption based on a careful evaluation of the facts. What, of course, is the death knell for good planning is when each manager concerned in the planning process operates on his own set of assumptions and "hunches". One value of planning is that it should co-ordinate the progress of the company. To do this effectively it is necessary for the strategic assumptions to be issued as an instruction before planning starts.

This is not to say that opportunity should not be given to managers to discuss the evaluations beforehand, and to play a part in making the necessary judgements. Once issued, the assumptions must be used, even if an individual manager disagrees and however violent his objections. If risk analysis is carried out correctly, no manager need feel aggrieved, since he gets his opportunity of evaluating his own bets as well as those imposed on him.

Assumptions should not be used as an escape clause. I have come across operating plans containing statements like:

* "We assume that our forecasts are right."
* "I assume that I will cut staff by 10%."
* "I assume that expenses have been correctly calculated."

This is meaningless, since these are events which are within the manager's sphere of influence—for instance, if he does not know if he is going to reduce staff, who else does?

Assumptions should not be blind guesses. In the initial stages of planning the element of guesswork might be fairly high, since the company may not have had time to identify the elements that really affect its business. In this case any definition is better than nothing since at least it becomes possible to assess the effect of variance. However, this is not a desirable state of affairs and it is possible to do much better.

Firstly, the company should set about defining what outside events really do affect it. This is where a number of bogies disappear, for many things are not as important as might be imagined. It is too easy to blame poor performance on the economy, the government or the weather, and to let this colour one's opinions about the future: too often these are just scapegoats for a more serious state of affairs. Very often the factor popularly blamed by those inside a company for all unfavourable variances has little effect in reality.

Part of the data required for setting planning assumptions will emerge from the external elements of the corporate appraisal. The study of the environment in which the company operates is not a once and for all exercise, carried out when the company engages its first planner. Instead, it should be a continuous process. A large part of a planner's duties should be concerned with studying the external events which have a bearing on corporate activity. This continuous probing is a most important feature of a good planning system.

The previous chapter gave some indication of the nature of environmental

studies, and touched on some of the methods by which data could be obtained. It is, of course, impossible to provide a check list of assumptions which will apply to all companies. Not only will the effect of an event vary between industries, but it will also differ between firms in the same industry. The shaky company may be forced into liquidation by a credit squeeze, leaving more customers to be shared out by those remaining in the industry. A bad English summer might affect the sale of swim-suits (or, more exactly, last year's bad summer may reduce sales of this year's swim-suits) but may not be serious for the firm with a large export trade. So the key assumptions must come out of a study of the expected effect of events on the business of each particular company.

Obtaining the data on which to base environmental predictions varies from the simple to the difficult.

* Some facts about the future environment are known long before they come into effect. Decimalisation and metrication are examples. Time-tables for change were established, and the probable results analysed in depth in numerous publications of both government and private enterprise. Assessment of the effect on individual companies may be more difficult. Another example is of changes in legislation, some of which will be known several years in advance.
* Government and other bodies publish predictions from time to time. Some of these have a high probability of accuracy—for example, population forecasts for the next 5 to 10 years include a large number of people who are already alive: it is in the area of birth rates that the biggest area of potential error arises, and the shorter the time span of the forecast, the less important this element becomes.
* In some cases a study of past trends from available statistical series may provide the best indicator of future events. The examination of weather records may, for example, indicate a pattern which will be repeated in future years.
* Often the statistical and other background data available are insufficient for a reasoned assessment. Marketing research may be required to provide the necessary information. The need for research was discussed in Chapter 4, although this was particularly in relation to establishing the *status quo*. Research to provide a base for future predictions may call for a different approach: certainly the results would be integrated with data from other sources to provide a network of forecasts. What

happens in many companies is that when they begin planning they identify the need for more and more special studies of environmental trends. Data that have little significance to today's profits may prove to be vital to establishing future strategies.

* Other assessments may have to be built on a study of the background of events. To many companies the question of worker participation is of considerable importance. Assessment can only be sensibly made after a study of the available political, social and economic facts, a consideration of the opinions of experts in the field and a study of trends in other countries.
* Technological forecasting has recently become recognised as an important means of making predictions that will guide future planning. In the words of Erich Jantsch as he wrote in *Science Journal* (October 1967), "Forecasting the Future":

  > Technological forecasting can provide information about the kinds of future development which are possible. It can provide a probabilistic assessment of the likelihood of each development, given the urgency with which it is desired. It is a way of charting the possible or alternative future. But modern technological forecasting is concerned with more than this. It is also carried out to influence the direction and pace of technological development.

  Predictions of future technological possibilities, often made for time periods well beyond the normal planning horizons, can alter the whole shape of a company's long-range plans. The nature of the company's activities will dictate the use to which it can put this technique.†

The effect of the key environmental trends on the individual business may also require the application of particular technique. The assessment may involve the study of past results (Did sales go up or down at the last budget?), marketing research (Do consumers really buy less of produce X when it rains?), economic research (Will consumers eat more or less of product Y if their income rises?), and careful judgement (What *would* happen if the company had to appoint worker directors?).

At this stage the planner is ready to set out a concise statement of the planning assumptions. How will the economy change over the next 5 years? What is the likely course of the business cycle? Is there likely to be any change in government legislation in an area vital to the company? Will there be devaluation? How will inflation affect the company, and what will the various rates of inflation be?

† Discussed in greater detail on page 103.

It will be apparent that part of a planner's task will be to collect and organise the data on which assumptions are to be based. This will involve obtaining the appropriate statistical series, analysing the company's own records and maintaining contact with a network of outside experts whose opinions might be valuable to the interpretation of the environment. The planner may not personally have to undertake all these tasks–existing departments of the company may assist, for there is little point in duplicating work. Outside agencies may be used to help in their specialist areas: for example, there are many firms which offer an economic forecasting service. (A useful world directory of these is published in *The Corporate Planner's Yearbook 1978-9*, edited by D. E. Hussey and published by Pergamon.)

On many occasions the defined assumption will be an opinion, but it will be an opinion on a logical basis, formed after careful study and therefore more likely to be correct than a mere guess.

Risk Analysis

These steps lead naturally to another–a form of risk analysis. If some probability factor can be assigned to assumptions, and if an assessment can be made of the financial results of variance, it becomes possible for top management to judge plans in a new light. Obviously there is a vast difference in a plan which has a 75% chance of reaching its target compared to one with a 90% chance. If the target is a vital one, it may be necessary to consider additional strategies that will bring a greater probability of hitting the figure required.

When assumptions are made, a table of betting odds should be prepared giving the probability of the assumption being correct. Over a long-range plan, the probability will not be the same in each year, and the expected outcome may be set out in this form:

	Out of 5 years probability of being correct in any				
Assumption	1 year	2 years	3 years	4 years	5 years
That no new competitor will enter the market	95%	75%	70%	35%	10%
That there will be no rail strike affecting the company	75%	50%	30%	25%	5%

The figures are for illustration only.

It will probably not be worthwhile attempting to predict *which* year an assumption will go wrong.

The probabilities arise from the exercise that developed the assumption. Frequently they will be based on informed judgement and experience (and, of course, are themselves subject to error). Sometimes they may be calculated from past data (for example, weather records or labour dispute records). The benefit of putting on the betting odds are that the company realises that its assumptions may not be correct. This is very important. Of course the company should always try to replace subjective with objective data and should never be satisfied with "opinion" probabilities.

Assessment of the results of errors in assumption can provide a cash figure of possible profit variance. This may be favourable or unfavourable, and there may in fact be a scale of variances depending on the intensity of the variance. In my opinion, this assessment should be made by the manager concerned when this form of risk analysis is applied to operational plans. Computer models can be of assistance in improving the scope and validity of these assessments, although it is quite a practical proposition to operate a workable method of analysis without computer assistance. The sort of answer which might result is:

Assumption that there will be average rainfall during summer.		*Profit variance*
Effect on profits of each week of below average rainfall		£5000 favourable
Effect on profits of each week of above average rainfall		£35,000 unfavourable
Total variance unlikely to exceed:	favourable	£10,000
	unfavourable	£100,000

Similar analyses should be developed for possible variances in the effect of strategy.

One of the jobs of the planner will be to draw together all the probabilities of occurrence, and all the risk analyses, into a composite figure, perhaps expressed like this:

> In any one year of the plan we are virtually certain of being within £15,000 of planned profits, and we have a 90% probability of being within £5,000.

Risk Reduction

The use of assumptions does not end here, as they should also be actively used to reduce risk. The "practical" man may feel that the probability

exercise is rather academic: he should not have the same approach to risk reduction.

The first method of risk reduction is the development of contingency plans. These can lead directly from the assumption:

Example 1: The plan is based on the assumption that the major competitor will not change his marketing strategy. What are we going to do if we are wrong? Alternative strategies can be developed for advertising, promotions, etc., so that an immediate response can be made if the competitor does not behave as predicted.

Example 2: An assumption is made that there will be no interruption to distribution through rail strike. A contingency plan can be prepared for the use of alternative methods of transport.

A portfolio of alternative plans can be very valuable as a means of speeding response to changes in conditions (and, of course, can be extended to cover failures in strategy).

The second area of risk reduction is "hedging". In the late 1960s a company may have based its plans on the assumption that the U.K. would not enter the E.E.C. At the same time, it might have extended trading links with E.E.C. member countries to serve as a basis for readjustment in case of an error in assumptions. An assessment that supplies of an important raw material (on which the company depends) are not at risk, may nevertheless lead to a policy of increasing inventories, or of giving a proportion of business to another supplier, as a hedge in case the assumption is wrong. Often actions such as these cost nothing, and can help the company to safeguard its future profits.

The third area in which risk is reduced is through the operation of an early warning system. If assumptions are clearly defined, and monitored on a regular basis, a change in circumstances will come to light at an early stage. The company can then re-examine its strategies and make the necessary adjustments to take it back to its profit targets. If it had not defined assumptions, or if assumptions were not co-ordinated throughout the company, the effects of environmental changes might not be realised until the end of the accounting period. One of the aims of planning is to enable the company to react before it suffers from an unkind fate, and the correct use of planning assumptions will help this to come about.

Obviously, the best planner in the world cannot foresee every untoward event that may occur. (The unprecedented 1968 floods in south-east England

and the collapse of the Rowan Point multi-storey block of flats in London, also in 1968, are examples of unpredictable blows to those affected.) Equally obviously, the company that does no formal planning will react to some things—often it will do the right thing for the wrong reason, and often it will see those changes in the environment which are apparent to all. But the company which consistently thinks in the way described should consistently have a competitive advantage: in other words, it gets more correct decisions than it could expect from chance alone.

Strategy

In effect, the discussion on contingency plans covered a large part of risk-reducing actions that can be taken during the formation of company strategy, but it is worth spending a little time to broaden the line of thought.

Firstly, the formal planning process insists on the consideration of alternative courses of action, and the course which evaluation shows to give the most favourable results will be selected. "Most favourable", of course, must be interpreted in terms of corporate objectives and does not always mean the course which gives the most profit in the short term. This identification of other ways in which the company can achieve its objectives—and the same argument applies in the consideration of grand strategies of expansion or acquisition as it does in the various elements that make up a marketing plan—has several advantages. Perhaps the biggest is that the solution first thought of is not always the best one. In addition, as with the deliberate plans made in case of errors in assumption, the company has a portfolio of alternatives ready made in case the strategy fails. It must be accepted that even if all the assumptions are correct, a strategy may not be successful because of other factors. To my mind both of these advantages lead to a reduction in risk. There is just one word of warning: the alternatives must be genuine ones. The chief executive must be on his guard against the manager who makes a snap decision of what he intends to do, and then produces afterwards a list of "rejected" alternatives as a means of keeping the chief happy. This form of corporate self delusion helps no one.

There are a number of well-tried techniques which are of value in the consideration of risk in relation to strategy. Each of these can assist in reducing uncertainty.

* Forecasts are more useful as they improve in accuracy. It is not realistic to assume that forecasting will ever become a certain science, but, at

the same time, it can be vastly improved in many companies. A good rule for making a sales forecast is to do it in three stages: the total economy; the total market; the firm's own sales in relation to the market, and the changes to these that different marketing strategies will

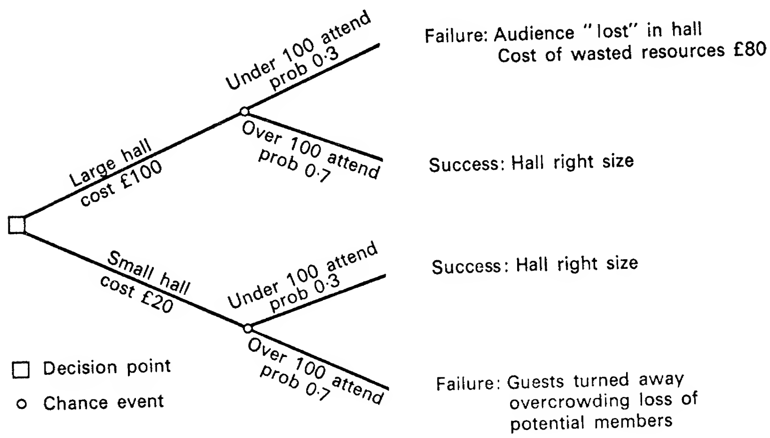


Fig. 13. Decision tree for the hiring of a hall for the inaugural meeting of a new professional society at which an unknown number of people will attend (hypothetical data).

cause. Statistical trends can be useful—for example, moving averages, semi-averages, "least squares", trend lines—if only so that the forecaster can be sure in his own mind of the reasons why his forecasts vary from the extrapolated trend. There is, however, no sound basis for assuming that market trends will follow the growth paths of prior years. Econometric models can bring a greater degree of sophistication to some forecasts, but are not within reach of all companies. For some types of forecasts—for example, labour turnover—a statistical extrapolition may provide the basis of the forecast, adjusted by the expected results of action planned by the company (perhaps a high turnover rate may lead to re-evaluation of an element of personnel strategy in order to achieve a lower rate).

* Confidence limits can be placed on forecasts where the company has a backrun of forecasts compared with actual results. Deviations can be measured, and a calculation made to give statistical confidence limits. If, for example, a manager has never been more than 90% accurate in his forecasts, is there any reason to expect he will be better in future? Of course, if circumstances have changed drastically, past data may be no guide.
* Decision trees provide a useful way of setting out complicated alternatives in such a way that management can see the expected results of all alternatives. For instance, the alternatives facing the founders of the Society for Long Range Planning in preparing for the inaugural meeting of the Society which could be attended by an unknown number of people might have been:

Alternative	Event	Result
Hire small hall	Less than 100 people attend.	Room just right for audience. Success.
	More than 100 people attend.	Not all will be able to get in. Stigma of bad planning.
Hire large hall	Less than 100 people attend.	Unnecessary expense incurred. Audience appears lost. Meeting a failure.
	More than 100 people attend.	Room just right. Meeting a success.

These are shown in the decision tree in Fig. 13. It is assumed that there is no possibility of altering this decision once made: if such possibilities did exist they could, of course, be incorporated in the diagram. In this simple example the benefits of the decision-tree approach are minimal—the data could easily be perceived in schedule form. It is not hard to visualise the more normal problem facing management, with all the numerous alternative decisions that can be made, each extending another set of branches. Besides setting down simple alternatives, it is possible to quantify the results (either at current or discounted values) so that the benefits and costs of each

decision can be seen, and to show the expected probability of occurrence.

* The various forms of network analysis (critical path, PERT, etc.) are of benefit in identifying all the steps necessary to the implementation of a

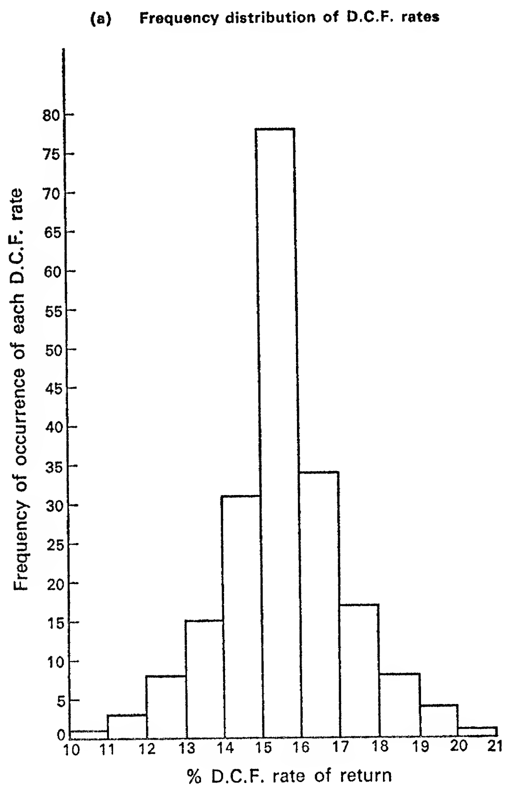


Fig. 14. Risk analysis: Hypothetical project.

decision, making sure that all work essential for the next stage has in fact been carried out in time. These methods can shorten the time needed to implement a course of action.

* In an appraisal of a course of action discounted cash flow (d.c.f.)† may be used. Accepting that forecasts are never absolutely correct, the

† d.c.f. is discussed in greater detail in Chapter 12.

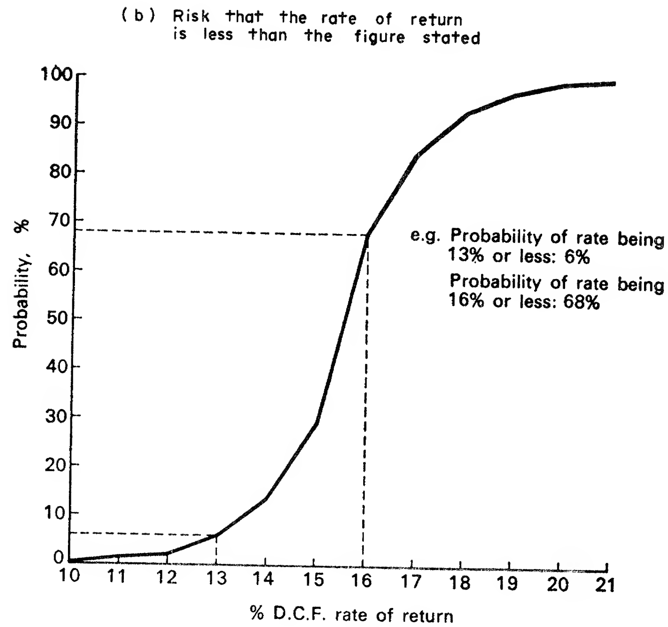


Fig. 14. (cont.)

planner should see that a number of appraisals are made to cover different circumstances: in addition to the expected result, there should be a pessimistic and an optimistic result. This focuses management attention on the fact that there is not one firm answer, and that the degree of risk—if the pessimistic result applies—may be greater than they are willing to accept. There is, of course, no need to restrict the studies to three: it might be desirable to assess the sensitivity of the d.c.f. rate to various changes in volume, prices, expenses, or capital expenditure values.

* The sensitivity analysis has to be limited if carried out by hand, because of the complexity of the calculations. Using a computer, it is possible to develop a more detailed risk analysis by Monte Carlo techniques. Numerous calculations are made, each of which yields one value for each variable. By random selection one value for each variable is taken from each set of values, and used to produce a d.c.f. analysis. The process is repeated a large number of times so that a frequency

distribution of possible d.c.f. rates is built up. From this it is relatively easy to calculate the statistical probability of each rate's occurrence, and to plot these results in diagrammatic form (Fig. 14). Using this chart, the manager can read off the likelihood of obtaining a return lower than that considered acceptable.

In addition to these specific techniques, the planning approach focuses attention on the numerous well-known risk-saving tools in common operation. The company that plans must develop a good management information system, it is likely to make great use of marketing research, and will almost certainly test new market concepts before "going national". These things do not themselves spring from planning—but their need will be more obvious to the company which does really think about what it is setting out to achieve.

Finally, the process of monitoring and controlling plans means that errors in strategy can be discovered at an early date and, equally important, ensures that managers perform the tasks to which they are committed. In other words, risks due to neglect or non-performance are considerably reduced.

The application of the methods discussed in this chapter can bring many benefits to a company. The benefits are never enough to make the chief executive's job an easy one—but they can make it just that much more certain that he will continue to have a job to manage.

The methods represent only a beginning to the tasks of analysing strategy. A more detailed study, and an introduction to some further analytical techniques, is the subject of the next three chapters.

CHAPTER 6

STRATEGIC PLANNING

The Strategic Task

The company is now in the position of having identified its strengths and weaknesses: it is aware of the limiting factors which can be removed gradually, as well as those which will act as a constraint on its progress for some considerable time to come. It has defined its objectives—it now knows what profit it has to make over some suitable time-span. The trends in the environment have been assessed, and workable assumptions established on which the planning can be based.

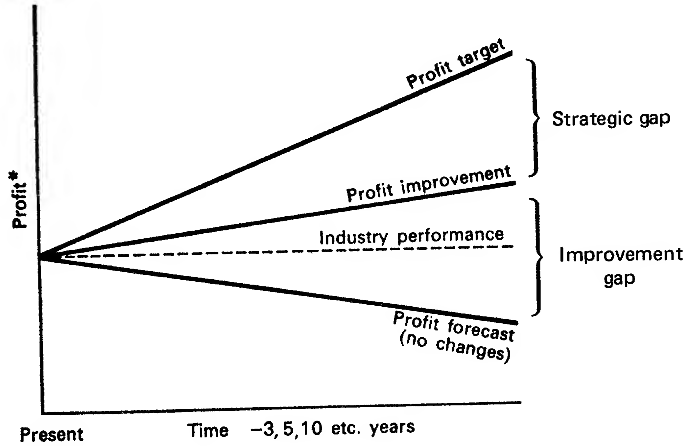
It is in a position to tackle the strategic task, determining what paths it will take to achieve its objectives. These paths must not only lead it to the profit targets it has set itself, but must ensure that the company has the balanced development which the chief executive considers desirable. Even if profits can be met from further investment in current operations, it may be thought that this is too risky a situation and some form of risk-spreading may be required.

Some areas of opportunity will have been revealed by the corporate appraisal, and many major decisions may arise from the factors uncovered by this important step in corporate planning.

But the starting point for the many strategic decisions is the profit target which the company has set itself. How it will meet this will be set out in the strategic plans shown on the right-hand side of Fig. 1 in Chapter 1—whether the company chooses to bulk these together in one strategic document, or whether it needs to develop an individual plan for each, is a matter of personal preference in relation to the volume of work involved in each company. If the company is simple in its breadth, one document may suffice: if it is complex, a more detailed approach may be needed in order to reduce the data to more manageable units.

In any event the strategic plan should consist of:

* A statement of the corporate objectives.
* The assumptions on which the plan is to be based.
* The strategic elements arising from the corporate appraisal.
* An assessment of the profit "gap" (see below).
* The means by which this gap is to be removed.
* The financial results of the plan.
* A detailed analysis of risk.



* Could instead show R.O.I.% or sales if required

Fig. 15. Gap analysis.

The total plan is underpinned, as we shall see in a later chapter, by the operating plans of the established areas of the company.

Gap Analysis

One of the first tasks is, therefore, the assessment of the profit gap. To assist in this there is a very simple technique called appropriately, "gap analysis". This is shown diagrammatically in Fig. 15.

The first line on the diagram is the easiest to draw in: this represents the company's long-range profit targets–the line shown in the diagram is perhaps neater than one is likely to find in practice, but suffices to illustrate the problem.

Next, and more difficult, comes the profit forecast of the company on the assumption that no changes are made to its sphere of operations. Perhaps it is significant that corporate planners usually draw this line so that it plummets downwards at a rapid rate, thus proving a need for corporate planners! In fact the line can move in any direction.

There are three ways of obtaining this line—the forecast of the "present position"—but in the final event these will reconcile into one figure. The first line that can be sketched in is the sum of the profit targets which have been set individual operating divisions: this, of course, assumes that all divisions will meet, but not exceed, these targets. Profit targets should preferably be agreed in a participative way, and should be discussed in detail with the key managers involved before being firmed up. The second way—which perhaps is a variant of the first—is to make a simple model of the company's profits under certain defined assumptions, and to use this forecast in the analysis. Thirdly, it is possible to obtain the operating plans from line management, add these all up, and use this as the relevant data. (It should be stressed that good strategy is rarely arrived at by simply consolidating lower level figures, a theme which will be developed in later pages.)

I find that I usually work by preparing a simple model based on the divisional profit targets, and making any necessary adjustments to this after receipt of the operating plans. To me this symbolises the circular relationship of many plans, the numerous "chicken and egg" situations that have to be faced, and the combination of "top-down", "bottom-up" communication which is a feature of all good planning systems.

If corporate targets have been well thought out, there is likely to be a gap between what is required and what is currently expected. This does not follow automatically, of course, and some companies may find that they can adequately meet their targets (which ***might*** indicate that a revision of targets should take place).

The next two lines on the figure are perhaps something of a planner's dream, but they are useful in theory. One is the profit on an equivalent investment which is expected from the rest of the industry in which the company operates. This is often difficult to obtain in practice, although the company may be able to carry out some useful exercises with what data are available: certainly it should try, for if it is obtaining returns lower than the rest of the industry it may have a lot of problems on its hands. The next line shows the level of improved profits which might come from making alterations to the strategies of the existing sectors of the company. Why it is

something of a dream is that in a good planning system it will already have been built into the targets and plans of operating management. Where it may be valuable is when the strategy calls for improvement through divestment, or when a corporate improvement plan is maintained over and above the normal operational planning. In most companies, the "present operations" line and the "improvement" line are likely to merge, at least after the completion of the first long-range plan. (In the very first plan the improvement gap may exist and may be revealed by the corporate appraisal.)

The difference between the best that can be produced from current operations and the profit target is the important gap for the strategic plan. This is the additional profit that the company must find from the various alternatives open to it: this is what the corporate strategy is all about.

Now, what happens if the strategies devised to fill the gap succeed so handsomely that the target is surpassed, or on the other extreme, if they fail to come within reasonable reach of the target? In the first case the target should be upgraded, since it has obviously been set too low (assuming the forecasts are realistic). In the second case the issue is not so clear cut. If the target is doing its job it should represent the chief executive's interpretation of the profits that have to be earned to satisfy the owners of the business—the shareholders. In these circumstances he should be prepared to take drastic action: to re-examine all the thinking behind the analyses: to really make sure that no opportunities have been missed—especially those opportunities which another person might spot. I would accept the downgrading of targets as a last resort—but the chief executive will know that, sooner or later, failure to satisfy the shareholders will result in his head being placed on the chopping block. Perhaps the answer would be for the company to get a new chief executive—or for the chief executive to get a new planner. Certainly, failure to devise a means of attaining the corporate objectives must be treated as a very serious matter.

Formation of Strategy

Every company has more than one path along which it may travel. For example, the smallholder growing vegetables can increase his sales in a variety of ways: he can expand extensively, buying the farm next door: he can increase production by intensive methods by applying more resources to his present operations, sowing a better type of seed, applying more fertiliser, irrigating and the like: he can diversify, by growing different types of crops from those at present under cultivation, or by adding a goat or a pig: or he

can obtain a higher gross realisation for his produce, by tackling the marketing side of his business in a more sophisticated way. He may follow only one of these paths. He may opt to try all of them. Alternatively, he may decide that his present efforts are quite rewarding enough and that he should carry on doing what he has always done. Probably he will not even perceive the decision situation as an overall system of choices, and will regard each alternative as an unrelated decision, without thought of the others, unless, of course, he practices some form of corporate planning.

Corporate strategy should be seen as an evaluation of the various alternatives open to the company, and a selection of what appears to be the optimum course or courses of action to take. In making this decision the chief executive should have regard to the company's strengths and weaknesses, and the long-range trends that the company forecasts for the environment.

This evaluation may be extremely complex in, for example, the major multi-national company. Ways of approaching this task are the subject of Chapter 8.

Profit should never be the only criteria in deciding a course of action and some account must be taken of risk. Mention has already been made of this (Chapter 5) but it is worth stressing that the strategies eventually decided must be capable of meeting profit targets within a reasonable degree of accuracy. The chief executive cannot afford to be satisfied with a strategy that has only a 50% chance of hitting the required target–although he may feel that a 90% probability of being within 10% either way would be an acceptable risk. The risk balance of the company must also be taken into account. If the company is too dependent on one or two products it may feel that its long-term future is being jeopardised, and may slow down on further investment in these areas, preferring to move into another area although the returns may be slightly lower.

The example of the horticulturalist covered the broad types of choice open to a company. Put another way, these are:

* *Finding new markets for existing products*
  For example, attacking new segments of the market, selecting new channels of distribution, or expanding geographically.
* *Marketing new products for existing markets*
  For example, another type of suit in the clothing company, a new flavour of toothpaste, doing "own-label" branding for others, finding a

product that moves through the same channels and can be sold by the usual sales force.

* *Marketing new products for new markets*
  Moving into something completely new, such as the tobacco company which has diversified into (among other things) potato crisps, and the soft drink firm which moved into tea and other lines.
* *Improving the performance of existing products in existing markets*
  For example, putting more sales effort behind the products so that turnover is increased, or changing other marketing strategies (advertising, price, merchandising—or indeed any of the elements of marketing strategy—to the same effect).

The ways of following these broad courses of action really follow the headings we saw in Fig. 1 of Chapter 1: research and development, acquisition and merger, expansion, divestment and improvement.

There are perhaps three schools of thought in the selection of alternatives. One, which need not concern us since its exponents are unlikely to use corporate planning, is an opportunist strategy. This suggests that expansion and acquisitions should be taken as they arise: each is an *ad hoc* decision stimulated by the opportunities of the moment. Now, there is some merit in having an opportunist element in the strategy, and no chief executive can afford to turn down a bargain opportunity just because it has not been written into the plan. What he must do, though, is to make sure that this bargain is in line with his objectives, and that the company is still moving in the direction in which he wishes it to go. The ability to deviate from a planned strategy is a form of the management judgement called for when the strategy was set up: a rigid plan which demands a blind allegiance is not a good plan, and a rigid management is not a good management.

The second school of thought is that the company should actively evaluate all foreseeable opportunities open to it, which may mean it entering new industries. Professor H. Igor Ansoff's book *Corporate Strategy* (McGraw Hill, 1965) provides a logical and systematic method of evaluating and selecting alternatives. His systems of evaluation take into account the concept of synergy. Synergy is usually explained by the term "two plus two equals five", and it means that when the new business area is added to the old there should be an interaction which means that the profit generated is greater than it would be if the two parts had been operated separately. So synergy will be related to things like the specialist skills of a company, its management talent,

its marketing channels, its physical distribution operations, and the products of its research and development effort. This means that the company, although it may become a conglomerate through the application of these principles, will not be a glorified unit trust, operating on a risk-spreading plus high profits basis.

For some types of companies this is the best way to develop strategy, and Ansoff's book has done a great service in providing a systematic framework for making these decisions. (There is also much of value in the book for the companies which follow the third, and narrower, school of thought.)

This is that companies should develop along fairly well-defined paths, and that opportunities will only be sought within those paths. The secondary objectives of the company show what areas are open to the company in the answer to the question "What business are we in?" This school of thought argues that in many companies the chief executive should stay within an industry field in which he has knowledge. He may move into closely related industries—such as the fruit and vegetable wholesaler, which opened a business merchandising supplies to the growers of the produce he sold—or he may integrate backwards or forwards.

There is a good deal of merit in this school of thought for certain types of companies, and where the right sort of growth and returns can be achieved from the defined area. Even within the narrower limits the field of opportunity can be very wide. I think this sort of basic strategic decision appeals to many companies, and there are a vast number of chief executives who would not allow their companies to take on the role of a conglomerate. At some later stage in the corporate development a change of thinking may become necessary.

Possibly the results in practice are not always different from those that would be achieved under the second system, since the synergy rating on related activities would be very high. The difference is in the breadth of the concept.

Finding New Opportunities

One of the tasks of a corporate planner is to help the chief executive to find new areas of opportunity, and this job should be tackled in an aggressive way. Opportunities can be uncovered by various methods, and what is important and different about the planned approach is the way that new areas of profit are deliberately sought. A real effort is made to seek paths of growth and development which would be unlikely to arise from chance alone.

Where should the planner begin to look?

The marketing-oriented company will start at the source of all its profits—the consumer. By studying consumer desires and requirements through a planned programme of marketing research, and through constantly revising market strategies, new opportunities are likely to be uncovered. These have a high probability of being related to the businesses the company is currently operating in. This constant probing of markets is vital, whether the company is selling products or services, consumer or industrial goods.

The continued studying of the future environment will lead to different ways of doing things, and new areas of business to enter. A trend which the planner foresees and which is adverse to the company's interests may lead to a strategy which is designed to either take advantage of the new trend, or to do something which will mitigate its effects. This act of trying consciously to foresee the direction of the various factors in the environment is an important one. Not everything can be foreseen, but a surprising number of problem areas and opportunities can result from the constant application of effort to environmental studies.

A third source of new ideas is the work the planner should do in evaluating potential opportunities in new areas. In this exercise he will, of course, be guided by the objectives of the company and may as a result restrict his activities to certain geographical areas, or to selected industries. The preliminary data that require to be collected are the extent of the opportunity, the investment required (and several levels will usually be possible) and the expected profits that should result. So as well as studying the environmental factors influencing the firm, the planner will have a programme of "desk" research (the study of market data from published sources and informal contacts), comprehensive market surveys where necessary, studies of the records of other companies in the fields of enquiry and the collection of the necessary data from company engineers on probable plant costs. Although the planner is likely to initiate this work, he will not necessarily have to do it all himself. As with other areas of planning, use should be made of appropriate people in the company. If a marketing research department exists, this could help in the collection of data on the markets and could carry out the appropriate surveys. A work study department could well help in estimating labour requirements. These are simple examples of a principle which I think is basic to good long-range planning—the involvement of as many people as possible in the planning system. In some cases consultants and outside agencies may be used.

Desk research may not sound very exciting, but it can yield valuable data about markets and the performance and activities of other companies. It means that some projects can be eliminated at an early stage before great expense is incurred, and that all future steps add to the store of knowledge, rather than duplicating the data available already.

Opportunities may also arise from the corporate appraisal. This can frequently indicate new alternatives and requirements for the firm to consider.

High technology industries in particular should obtain new ideas and products from the research and development effort. The aim should be to *manage* research and development, and to follow a plan, rather than relying on haphazard and chance events.

If the planning processes are working well, the constant review of their operation, and the thought that they are giving to the future, should encourage a flow of ideas from managers within the company. Each line manager will have theories about how his sphere of responsibility is to develop. These internal ideas provide a very valuable source of opportunity for the company.

Finding strategic alternatives for the company is not a question of sitting behind a desk waiting for things to happen. There is a great deal of hard work involved—work which may be shared out among various areas of the company, or which may be performed by the planner—but the deliberate attack on the future is by no means impossible. One object of strategic planning is to remove the chance element from corporate growth, and the more alternatives the company finds that are worthy of serious consideration, the more likely it is to be able to select a path that will take it to its profit targets.

Degree of Detail in the Strategic Plan

The strategies selected will be known to the company to a varying degree of detail. This does not mean that the plan becomes full of wishful thinking and pipe dreams, and some evaluation should be carried out of every alternative which appears.

The plan may reveal the company's intention to enter industry "A" by acquisition, and while the exact cost of acquisition may not be known, the company must be reasonably sure that there is an acceptable profit to be earned in the industry and that acquisition is the most appropriate means of entering the industry.

Similarly, a plan to double capacity of a factory may only be known in broad parameters, but a reasonable working estimate can and should be made of capital requirements and returns.

On the other hand, the investigation of a particular alternative may have progressed further, and the company may be in possession of its final appraisal of the course of action. Similarly, an improvement scheme may have been thought out in detail, and the company may have very accurate knowledge of what steps it is going to take. A divestment plan is also likely to be known in fair detail before the question of divestment enters into strategy.

I think it is sensible to accept this mixture of levels of detail, and would not find statements like this amiss (assuming profit targets can be met in this way):

* The company will select three of the five alternatives discussed in this plan, and will carry out one of them in each of the next 3 years.
* The company will enter industry "A" in year 2 of the plan and will invest up to £1 million in this project, to yield a minimum R.O.I. of 10% in the first year and an average d.c.f. rate of return of 15% assessed over a 25-year period. The means of achieving these results will be selected from the various alternatives by the end of the first quarter of year 1.

  Should final evaluation prove that these targets are impossible, the company will expand its factories in France by . . .

In the next 5-year planning cycle, the company will have progressed further in its studies, and will be in a position to be more specific. But I do not believe that the statements above represent bad planning: in each case the company is committed to a course of action that will bring the profits it requires—it is just that there is still some flexibility in the means.

All strategies should receive a final evaluation before the company irrevocably commits its resources to them, and the later it is possible to postpone this, the more likely is the company to be able to make an accurate assessment. If this study proves that the company is wrong, it must of course revise its strategy: if alternatives have been properly considered it will already have a course of action prepared which it can take at short notice.

This really stresses that all plans must be flexible. Blind allegiance to a course of action because it is written into the plan is a form of rigidity in which no company can afford to indulge. Of course the best-laid strategies can change—perhaps because of different environmental circumstances, or

perhaps because the opportunity is revealed to be iron pyrites, fools' gold, and not the precious metal that the company was seeking.

It is a very unfortunate company that finds its total strategy unsuitable, but even this should not be a disaster if the company has laid aside its nest egg of alternatives.

Financial Results of the Plan

Some companies prepare a simplified *pro forma* profit-and-loss statement and "balance-sheet"–if one may use the term to describe an expected result at some future date–for each of the years of the plan.

I prefer a simpler approach, and would recommend that the strategic plan showed only details of before tax profits by source, total after tax profits, and capital employed. More detail would appear in the subsidiary plans. This can be analysed to show R.O.I. and growth percentages.

The exact way of presenting these data, and the amount of detail shown, are a matter for the company concerned, and requirements will vary.

Risk analysis is important, since the chief executive must know if he has a high probability of reaching targets, and whether he is likely to exceed them. The methods of risk analysis have already been described.

An Example of a Strategic Plan

This chapter has covered a large number of concepts. Before progressing to the individual elements of strategy, such as acquisition and divestment, it is as well to take a look at what a strategic plan *might* look like, and in this way help to bridge the gap between theory and practice.

Because a firm's long-range strategy is among its most confidential documents, the example has to be of a hypothetical case. It is also a shorter plan than would be likely in practice, partly because a fictitious case enables some simplification to take place, and partly because some of the arguments are not fully developed. (The example shows only two planning assumptions, whereas a real-life situation might have many more.)

The example shows only one way in which the plan might be put together. In reality, there are many other ways which are equally effective for planning as few "right" and "wrong" answers; much depends on the approach of the planner. My own experience is that there needs to be a careful attention to the needs of the company and the critical issues it faces. This results in wide variations of presentation and contents. A major complex organisation might

need to write its plans around a portfolio analysis, delegating the more detailed planning to a lower level of management.

Although few plans will be as short as this example, the aim should always be to reduce the data to as little as possible. The value of a plan lies in the thought that has gone into it, rather than its thickness or number of words it contains.

Our example is of a hypothetical firm in the heating and ventilating contracting industry. All profits evolve from this activity and the company has a current before tax profit of £250,000 resulting from a turnover of £10 million. Capital employed is £2.5 million, giving an R.O.I. of 10%. Most of the company's activities are tied to the building trade and over the past 5 years profits have fluctuated from a minimum of £50,000 to the current peak. It is a family business, and the owners are willing to invest more money in it if they can improve its performance and reduce the severity of its fluctuations. The managing director is 45, and has been in the chair for 1 year.

An assessment of the company's strengths showed that they were one of the leaders in their field, that they had considerable technical expertise, particularly in the design and installation of specialist heating and ventilating systems for computer rooms, laboratories, and other buildings housing sensitive equipment which required a fine degree of dust and temperature control. They had a good record in European export markets (15% of sales). Among the company's assets were the patents for a new system of home heating which for various reasons had never been developed. Finance was not a constraint.

On the other hand, the company had certain management problems and had difficulty in retaining good calibre middle management. Despite its good export record it had never developed outside Europe, and in the Scandinavian countries had over-estimated the competition and had undercharged on recent contracts. In addition it had the weaknesses of fluctuating profits and reliance on one product area for its profits. The company operated five plants and had a considerable surplus capacity.

The managing director sat down and after a good deal of hard thinking and analysis produced a strategic plan:

Strategic plan 1970–1974: Thru-Draught Heating and Ventilating Company Ltd.

1. *Profit Target*

		£ million		
1970	*1971*	*1972*	*1973*	*1974*
0.25	0.50	0.60	1.0	1.25

2. *Secondary Objectives*

A. The company is in the business of environmental control wherever and whenever it is required. It is engaged in the operations of designing, manufacturing and installing such systems.

B. The company intends to maintain good relations with employees and aims to treat all employees fairly.

3. *Goals*

	£ Million	
	1970	*1974*
A. Turnover–U.K.		
General Systems	6.8	3.4
Special Systems	1.7	6.6
Marine	1.0	3.0
	etc.	etc.
B. Establish technical services section 1 Jan. 1971		
	1970	*1974*
C. Number of managers to attend internal training course	5	25
D. Minimum number of man days lost in industrial disputes	100	100
E. Return on capital employed	14%	20%

4. *Assumptions*

A. The U.K. will enter the Common Market in 1973.

B. The U.K. economy will grow at the rate of 3% per annum over the next 5 years: the curb on public expenditure will be relaxed and the building industry will have a steady growth.

5. *The Profit Gap*

The task facing the company is shown in the table. Assuming no action is taken, turnover will grow to £15 million by 1974, but rising costs will swallow up the additional earnings and 1974 profits are forecast at £250,000.

			£ million		
	1970	*1971*	*1972*	*1973*	*1974*
Target	0.25	0.50	0.60	1.0	1.25
Current forecast	0.25	0.25	0.25	0.25	0.25
	–	0.25	0.35	0.75	1.00

(In any one year the gap could be larger than forecast because of the possibility of fluctuations. There is a 75% probability that in 2 years out of the 5 the gap will be up to £200,000 larger.)

6. *Improvement*

The company will take a number of measures which will improve its productivity, and make an immediate contribution to profit.

The short- and medium-term improvement measures are:

A. Production will be rationalised at three factories. This will enable the Warwick works to be closed within 6 months, and the Gateshead plant to close on 31 December 1970. Capital expenditure of £250,000 will be incurred during 1970 on modifications to the Bexley works to expand capacity.

B. A profit improvement of £250,000 per year will result by 1974.

(The personnel aspects of the rationalisation are covered in the Personnel Plan.)

C. Prices in Scandinavian countries will be increased by 20%. This will give profit improvement of £100,000 in 1971. (The effect will be lower in 1970–£25,000–owing to production time lags for contracts quoted at the old prices.)

D. The sales force will be reorganised with the effect of reducing the force by 5% and closing three regional offices. These moves will take place in 1971, and will yield £30,000 per year. No redundancies will be involved, and the programme will be met from natural wastage and the transfer of staff to new projects.

7. *Diversification Programme*

The product base of operations will be broadened, to reduce the proportion of profits dependent on the building and construction industry.

A. In 1970 a company will be acquired in the marine heating and ventilating field. Up to £1 million will be spent on this project which is expected to yield an initial return of 10%, rising to 25% in 1974. The reasons for this course of action are . . . .

B. The home heating patents will be developed in 1971. £100,000 will be spent on research and development in this area in 1971 and £250,000 for each of the years thereafter. Capital expenditure of £900,000 will be incurred in establishing the venture, which will yield a $33\frac{1}{3}$% annual return by 1974. The reasons for the high potential of this project are . . . .

8. *Geographical Expansion*

The skills the company possess in specialist environmental control will be used to spread risk geographically. Export markets will be developed, in particular Africa and Australia during 1971, and effort will be concentrated on the specialist areas.

The company will broaden its base overseas in 1973 and will acquire a company in either Canada or the U.S.A. Acquisition is considered necessary because . . . .

9. *Management*

Reorganisation of the company into profit centres will give middle management more responsibility which, allied to a salary administration system,

should make it easier to retain suitable staff. A more detailed evaluation of this problem will be made over the next 6 months and consultants may be engaged.

At the senior management levels action is also necessary. Mr. X will be retired and will be replaced from outside the company. A good marketing executive will be recruited to assist Mr. Y. . . .

10. *Concentration on Specialist Areas*

The company will reduce the severity of profit fluctuations by concentrating effort on the specialist areas in which it has greatest strength—e.g. computer rooms, laboratories, etc.—where the impact of the trade cycle is less pronounced. By 1971, 66⅔ % of sales will come from this area (18% in 1968). It will achieve this result by establishing a technical services department to provide a consultancy service for clients, and by giving salesmen an additional bonus on orders of this type.

11. *Financial Results of Plan*

Planned Profit (before Tax)

	£ million				
	1970	*1971*	*1972*	*1973*	*1974*
"Current" forecast	0.250	0.250	0.250	0.250	0.250
Rationalisation	0.300	0.050	0.100	0.100	0.100
Work Study	0.020	0.020	0.020	0.020	0.020
Export Price Adjustment	0.025	0.100	0.100	0.100	0.100
Sales reorganisation	–	0.030	0.030	0.030	0.030
	0.325	0.450	0.500	0.500	0.500
Marine Acquisition	0.100	0.150	0.175	0.200	0.250
Home Heating	–	0.010	0.150	0.250	0.300
Export expansion	–	0.050	0.050	0.075	0.100
North American Project	–	–	–	0.350	0.500
	0.425	0.660	0.875	1.375	1.650
Less R & D expense	–	100	250	250	250
	0.425	0.560	0.625	1.125	1.400
Probability of being within 10% either way	75%	75%	85%	90%	90%

Planned Capital Employed

	£ million				
	1970	*1971*	*1972*	*1973*	*1974*
Current plus improvements	2.75	2.75	2.75	2.75	2.75
Marine acquisition	1.00	1.00	1.00	1.00	1.00
Export expansion (working)	–	0.10	0.10	0.10	0.10
Home heating	–	0.90	0.90	0.90	0.90
North American project	–	–	–	2.25	2.25
	3.75	4.75	4.75	7.00	7.00
R.O.I.%	14%	12%	13%	16%	20%

The accountancy has been simplified by the assumption that depreciation is equivalent to increases in working capital.

Comments on the Example

A real plan would include a full risk analysis on the lines set out in Chapter 5, and should give more consideration to alternative strategies.

Now, it is possible to argue that the chief executive of the hypothetical company has prepared a poor strategy: this, of course, is his privilege. What is important is that he has recognised that his future profits are uncertain, and has set out to exceed his minimum targets to allow for fluctuations. He has also taken action to reduce the effect of the trade cycle on his business.

The plan provides him with a blueprint for top management action to put his company on what he thinks are the right lines.

The example is not the whole story of strategic planning, and our chief executive would have to carry out a lot more work before he could bring his strategies into effect. The next chapter looks at some further concepts which have to be considered in the preparation of a strategic plan.

CHAPTER 7

A CLOSER LOOK AT STRATEGY

We are now ready to give some consideration to the subsidiary plans of strategic management which feature on the right-hand side of Fig. 1. Those other important master plans dealing with personnel and financial functions will be discussed in later chapters. For the moment we should concentrate on the main courses of action which lie open to the chief executive.

Divestment

Sometimes a chief executive may have to face the decision to close down an area of his business. This may be because the corporate appraisal reveals that it is in a loss situation and unlikely to improve, or that it has no potential for the future: it could be because of changes, such as political action in an overseas territory which insists that all employees be indigenous regardless of suitability, or that profits may no longer be repatriated. It may simply be that he sees that the company's overall strategy would be better served if he concentrated management effort in other directions.

In many ways these are braver decisions to take than those involving the investment of new capital. If a failing activity is closed down, and someone else then takes it up and succeeds in improving it, the chief executive may find that he is judged harshly by the outside world. On the other hand, if he declines to begin a new activity only a few people inside his company will be aware of the fact, and the subsequent success of the operation by another is not used as a standard against which he is measured. There is, too, the tendency to hang on to an activity for too long, in the hope that it will improve, and a decision to divest will always have to be based on assumptions that may turn out to be incorrect. A new investment project is also based on assumptions, but failure of these will not necessarily result in a loss, although profits may not be as good as expected: there may be scope for contingency

action. But when a divestment decision is taken, any opportunities which may arise in that area are almost certainly bound to be lost to the company for ever.

So a divestment strategy calls for a fine degree of management judgement, and a large amount of management courage.

Of course this sort of decision may be large or small. It may involve the shedding of a product range that requires no change to production facilities, it may mean the closing of a factory or overseas subsidiary, selling those assets no longer required, or it may mean the sale of a section of the business to another company as a going concern.

In each case careful planning will be necessary to see that the divestment is handled in the best manner from the company's point of view. There may be far-reaching effects on personnel, arising from redundancy and redeployment, and it may be necessary to take steps to use the public relations function to refurbish the corporate image, which may have become a little tarnished during the divestment operation. Steps must be taken to see that the company's assets are disposed of in the most profitable way, and that the divestment is undertaken in a manner which has the least detrimental effect on the company's earnings.

Conflicting interests may have to be reconciled. On the one hand, it may be desirable to give early warning to employees and their trade unions of the action intended: on the other hand, it may be feared that such action would cause the key people to leave too soon, with the inevitable effect on production.

The divestment plan should cover these problems, and should receive as much management thought as any of the more attractive actions the company also intends to take.

Many chief executives may never have to suffer this type of strategic decision: all hope that it will not be necessary for them. But when it does become essential it has to be faced.

Consideration of Alternatives

All actions the company may plan are to some extent alternatives. If it decides to double the size of its factory, this may be considered a better course than starting up something new. But within the decision to get bigger in what you are doing or to diversify there are alternatives: not only alternative answers to questions like "How big an expansion?", but

completely different ways of tackling the problem. A decision to diversify brings the company to a crossroads. It can:

* Acquire another company.
* Obtain a licence for a new product.
* Develop a product from its own research, or where the technology of the new industry is low.
* Hire suitable people and begin operations.

Similarly, it is possible to plan for an increased share of the market by increasing the capacity of production facilities and adjusting marketing strategy, or by buying up a competitor in the same line of business (so long as this does not cause the company to fall foul of the monopolies legislation).

The company that practises corporate planning will evaluate these alternatives in its strategic plan, and will have made an objective decision of the course of action it intends to take: and it will have accepted that there is more than one method to choose from and will not have rushed blindly into a take-over bid because it was the fashionable thing to do.

Acquisition and Merger

The acquisition of other businesses is one of the glamour areas of modern management. In theory, acquisition offers a number of advantages where the circumstances are right. These advantages include:

* Opportunity for gain from synergy (although it must be remembered that the alternative strategies could have a higher synergy content).
* The ability to obtain immediate profits, rather than facing a period of loss for several years while business is built on a "green field" approach.
* It may bring valuable patents and licences to the company.
* In some cases it may be less risky than developing a completely new business.
* It may be the best way of obtaining a team of people with the required technical and management skills.
* In some instances it may be the only way to break into a market profitably.
* The reduction of competition (although the public in many countries has a watch-dog in government established Commissions).

* It may be the only way to weld together a worthwhile business in a fragmented industry (examples are the textile industry and machine tools): the opportunity may lie in reorganising the industry, rather than increasing competition.
* There may be financial advantages, such as the ability to acquire a company with large liquid reserves, by an exchange of shares.

Of course, in evaluating the alternatives, it is most important to ensure that the advantages really exist. There have been various studies which suggest that many chief executives are disappointed with the results of their acquisition policies, and that the expected additional profits from the synergistic effect have never materialised.

The planned approach does not leave acquisitions to chance. It is deliberate and, one might almost say, cold-blooded. A bid is not made for a company solely because a competitor has recently made an acquisition. It is not an action taken because it is fashionable, but because careful and objective analysis has revealed that this is the best course of action to achieve the corporate objectives.

Once the company has identified the opportunity area in which it wishes to expand, and has decided that acquisition is the right way to go, it becomes necessary to define with great care what type of company should be bought. At this stage the planner should not try to name companies which might be available, as this will only cloud his vision. Instead he should prepare an *acquisition profile*, stating as finely as he can the characteristics of the desired acquisition. In other words, he should describe the corporate identity of the organisation which will meet his strategic requirements.

The acquisition profile should both identify and quantify those factors which the planner believes it important that the acquisition should have. Concentration must be on the essential factors, which would cover such items as size, management capability, sphere of operations, technical skills. An example will make this clearer.

Acquisition Profile: Marine Heating & Ventilating Company

1. *Size:*	To cost not more than £1 million at an initial return on capital employed of not less than 10%.
2. *Products:*	Design and manufacture of complete environmental control systems for the shipping industry.

3. *Market position:* Must have at least 10% of the U.K. market and must have customers in more than five shipyards. Must have 25% of sales in export markets, including Norway, Holland and Japan.
At least 90% of sales must be in original equipment.
Turnover—about £1 million per annum.

4. *Technical position:* Must be accepted in its industry as a leader in technical innovation.
Over the past 5 years an average of at least 5% of annual sales must have been spent on research and development.

5. *Management:* Competent management at all levels is desirable. Good top management is essential, as is technical management at all levels.

6. *Factories:* Plant and equipment must be relative modern (90% of plant must be under 5 years old).
Factory must be located in the north-east of England. The site must have room for expansion, and it must be physically possible to treble output within 3 years.

7. *Conditions:* No company will be acquired unless it is possible to obtain all the voting shares.

This example is, of course, a hypothetical one. In practice, some of the characteristics identified may prove to be unimportant, and others which have not been included may be the critical factors. As the object is to mould the acquisition to the requirements of the individual company, factors which are vital to one firm may be insignificant to another.

The next stage is the matching of real companies to the acquisition profile. The way to tackle this is to prepare a list of companies in the field, and to begin to build up a profile of each of them. At an early stage it may be possible to reject some companies which are obviously too large or too small to be suitable. Of course, the shorter the list can be made, the less work there will be in developing the final profiles. There is a danger in being too precipitous. Even a large company may be willing to sell off one sector of its business under some circumstances, or it may be possible to combine two or more small companies to meet the overall requirements of the profile.

A statement that a list of potential candidates is required is one thing: making the list is another, and this is not always easy. Some of the basic sources of data for such a list are discussed below:

Directories

The many admirable trade directories make an excellent starting place. It will usually be found necessary to amalgamate a number of directories, and even then the resulting list may not be complete.

Supplementary sources of data include lists of memberships in Trade Associations, when these can be legitimately obtained. It is often possible to purchase lists of companies in specific product sectors from direct mail firms.

Directories vary in accuracy and in the scope of their content, but will frequently yield information on such items as main products, factory locations, number of employees, turnover, and affiliations to other companies.

Company Reports

Information on shareholders and certain statutory financial data can be obtained from a search at Companies' House (the name of the company must be known). In many cases this can be supplemented by the company's published report to shareholders. There are organisations which provide an excellent service in scanning and extracting information from these sources, publishing regular reports on a large number of public companies.

Market Intelligence

Publicity statements, newspaper and magazine articles and even trade advertisements can yield a rich harvest of valuable facts. It is easiest to consult these if a market intelligence section is run by the company, which would index and file all potentially valuable data so that it could be retrieved at a later date. Without such a system, the task of scanning back numbers of innumerable publications can be a formidable one.

Information from these sources may be varied in nature. Market shares, sales office locations, product range, plant capacity, labour relations records, the size of the company's own lorry fleet, developments in research and development, are a few examples.

Market Surveys

Original marketing research provides a good source of data, yielding lists of candidates, market shares, product image and the like. Surveys can also be specially commissioned to investigate, for example, the corporate image of the candidate. Such an action might be desirable to obtain data for the profile above on the degree of acceptance the industry has of the candidate's technical leadership.

Personal Knowledge

Within the company there are often stores of knowledge of the activities of potential candidates for acquisition. This is not to advocate a policy of industrial espionage, and *definitely* not the "persuasion" of an employee to divulge information about a company for whom he has once worked. But contact with customers or with competitors in the same industry means that it is often possible to build up a dossier of odd facts from legitimate sources—extent of sales coverage, methods of sales, competence of management, location of facilities, product strengths and weaknesses, age of top management, employee relations, and, less detailed but potentially useful, further additions to the list of potential candidates.

As new batches of data come to hand, the planner is able to create a short list of companies which might be acceptable. The final list should be written up in order of desirability. If no companies at all emerge from this process it may be necessary to re-examine either the basic strategy of acquisition, or the profile itself. The ideal partner may not exist, and something less than perfect may have to be accepted.

At this stage the chief executive should develop a provisional plan of what he wishes to do with the company if his bid is successful, in order to maximise the effect of synergy.

The process of opening negotiations with a company, either direct or through an intermediary such as a merchant bank, is outside the scope of this book, as are the many legal implications of take-overs and mergers, and the methods of valuation. This, of course, is a vital step in the whole process, but one which should not necessarily involve the planner. He may happen to be the best man to perform these tasks, but this is not necessarily so.

I believe that the planner should be involved in the acquisition study at a point before a firm bid is made. His purpose is to look at the acquisition from a slightly different angle from that used by others in the company—to check that at the figures arrived at, the candidate for acquisition still fits the corporate strategy. This means that he has a duty to question the valuation, not so much from the viewpoint of the fairness of the price, but to ensure that this is the best use of corporate resources. This process may have to be repeated as negotiations progress, if the bid has to be increased. The planner should also advise on the terms of the bid, and the long-range implications of these.

At about this point the chief executive should draw upon the skills of his planner and any other appropriate members of his management team to refine his provisional plan for dealing with the company in the event of a successful bid. Responsibility should be assigned to a particular member or members of his team to perform particular duties in connection with the acquisition, and a time-table should be established to ensure that the necessary action takes place. In any integration process, speed is of the utmost importance, and although there will always be areas in which insufficient data are available for sensible decisions, it is vital that any necessary post-acquisition investigations be pursued with alacrity and diligence.

Failure to act within the first few weeks of acquisition can cause difficulties later, particularly if there are redundancies or alterations to management responsibilities in the newly acquired company. Many human problems will be caused if action is unnecessarily staggered over a lengthy period, since each fresh burst of decisions will cause anxiety to those who have not yet been investigated. It goes without saying that appropriate action should be taken to ensure that the services of key staff in the acquired company are secured.

It follows that the speed with which decisions must be made will mean that a broad brush is used, and that some mistakes are possible. This is preferable to the blight of frustration and despair that can settle on a whole company as it desperately awaits the announcement of its fate. Speedy action avoids the paralysis which follows this blight: slow and sporadic outbursts of unpopular decisions may extend it indefinitely.

The third path, to take no action at all to integrate, may mean that the expected synergistic results do not materialise.

So far the discussion has centred on the situation where the company is in

a position to be very specific on the criteria for the companies it wishes to acquire. In some firms the position may be a little different, in that the choice may have been limited to a company of specific characteristics, but there may be scope for choice in the operations of that company. It may be of little strategic importance whether the acquisition makes canned meat or frozen peas, although it is likely that some parameters will be set for product and geographical sphere of operations. It is not hard to visualise circumstances when this method would be the most suitable one. A company with a large diversification programme may prefer to operate within the broader frame, on the premise that any four of, for example, ten types of industry would meet its strategic requirements. Another situation where this approach may be preferable is with the conglomerate which is actively seeking investments over a wide range of possibilities.

Business Activities

The XYZ Company intends to diversify into four new business areas, and to achieve this end will acquire suitable companies in the food industry in Europe, the U.S.A. and North Africa.

Acquisition efforts will be concentrated on companies which have a demonstratable record of product development. The companies must have strong franchises in advertised and branded consumer food products, and must hold not less than 10% of the domestic market.

Food industry investments will be selected from companies in any of the following areas:

Coffee and tea.
Canned foods. .
Pet foods.
Sweets and chocolates.
Sauces, pickles and condiments.
Frozen foods.

Restriction

Not more than two companies will be acquired in any one country, and not more than one well be in North Africa.

Size

The minimum size of any company by turnover will be £3 million per annum, of which at least 75% will be domestic sales.

Profitability Criteria

No acquisition will be considered that does not offer the prospect of returning 10% on shareholders' capital, within 3 years and after taxes. The average return on capital employed during those 3 years must not be less than 8%. Profits (after tax) of at least £300,000 per year must be possible.

Any acquisition in North Africa must yield 20% return on capital employed, according to the above definitions.

Ownership and Management

No company will be acquired unless at least 80% of equity can be obtained, and 100% is preferred.

The competence of management, proved by past records, and the continued availability of key people is an essential factor in any acquisition.

In either approach to acquisition profiles it is essential to try to establish areas of synergy. The various criteria should, of course, bear this concept in mind, and at the various evaluation stages when the corporate planner examines the merits of individual acquisition candidates areas of synergy should be very much to the fore.

The acquisition path can bring great rewards, but is also beset with many dangers. It is neither the way for the fainthearted nor the foolhardy.

Expansion

The company's strategy need not involve acquisition at all, and the concept of synergy may be used in considering the other ways to profit which are at the company's disposal.

It may, for example, be decided that the best action to take is to expand the areas of activity in which the company is already engaged. This decision

will have a very high synergy content, but may not improve the balance of risks in the company. The long-range plan would define the maximum capital expenditure on each of the existing areas of the company, the time-table of events, and the expected results. For many firms, it is administratively simpler to transfer this element of strategy to the Divisional Operating Plans, and the methods will be described in more detail in a later chapter. However, this alternative should be considered when the total strategy is evolved.

Three ways of diversifying can be conveniently considered under this heading. The first is open to firms wishing to enter industries with a low technological threshold. In many cases it is possible to retain consultants to train operatives in the new machinery or plant, or some machinery manufacturers will send a technician to teach the labour force for as long a period is required.

The second method is to hire key personnel with the requisite skills and technical expertise. (It would probably be prudent to do this also in the first example.) The disadvantage is, of course, that a good deal of confidence may have to be placed in people who are an unknown quantity. But this strategy would enable diversification into areas of a higher degree of technology than would be possible under the first method.

The third opportunity is to obtain licences for processes, or the rights to patents. Agreements are possible on a royalty basis or, sometimes, outright purchase of the invention, process or formula. In some cases it may be possible to facilitate entry into a new market, by acquiring the licence to a well-known trade mark: in the simplest of situations this may involve little more than a quality-control definition, and the right to apply the brand. Any licensing arrangement may require the hiring of key personnel, although it is frequently possible for the licensor to provide facilities for training. Such agreements may be better as joint ventures, so that a continued flow of data becomes available from the licensor, who is also able to maintain some control over what happens to the licences. Licensing is, of course, very common in industries requiring advanced technology, and for the company selling the licence the method offers a means of gaining income without all the risks of exploiting the opportunity by other means.

Licensing presents a special problem, in that it is not always easy to find companies with licences on offer. A continued study of technical literature may provide the right leads, but possibly the best way to proceed is, having identified a range of licence requirements, to use the services of one of the agencies which specialises in bringing interested parties together.

Research and Development

Diversification can also be obtained from the firm's own programme of research and development—and, of course, this may also be used to help the marketing effort by finding new uses for existing products, or by bringing about continued product improvement.

Research and development is one of the most difficult areas to bring into the formal planning philosophy, yet in many companies it is an area of great expense, on which the future profits depend almost in their entirety. The importance of R & D will vary with the philosophy of the individual company, and the state of technology in its industry.

There are many problems in managing research and development which are receiving a great deal of attention today. Much remains to be done.

In my opinion an R & D plan should seek to clearly establish research targets for every product being considered. Why is the research and/or development work needed, and what does it seek to achieve? The setting of this type of target should not be left solely to the manager of the R & D department. He must be guided by marketing needs, and top management strategic requirements. I like the type of research target which not only describes the requirements and physical performance of the product as perceived by marketing department, but also gives guidance on the cost brackets within which the product should ultimately be manufactured. This type of guidance prevents a new product being developed which cannot be sold profitably because its production costs are too high.

Alongside the research and development targets should be set an expression, quantified where possible, of the benefits that success in this area would bring.

Equally important is priorities. Again the R & D manager cannot set these by himself, lest he fall into the trap of doing work which interests him most, rather than work which will contribute most to the company's success. Top management will have to give guidance on the most important strategic areas, and a way will have to be found of reconciling the various claims for attention of the other departments of the company. Methods have been developed so that priorities can be expressed objectively in quantitive terms, but there is still room for improvement in the techniques used.

Another factor required for the plan is the maximum amount the company is prepared to invest in research and development on each project. In some cases, in for example pure research, there may be no limit, and the

company may be willing to invest indefinitely in various lines of research in the hope of gaining a worthwhile discovery. In, for example, development work it may be possible to see that £x research would bring a benefit to the company, but that at £$3x$ it might take an overlong period for costs to be recovered. It is, of course, important for the R & D manager to assess whether any worthwhile research is possible within the parameters set.

The plan should also include schedules showing the time required for each project, and the disposition of the resources of the company.

The amount of detailed planning which can be carried out in the R & D area will vary from firm to firm. In some companies, particularly where the accent is on development work rather than research, it may be possible to plan ahead for a period of only 2 to 3 years, although the company as a whole may plan for a longer time span.

The modern tendency is for research thinking to probe deeper and deeper into the future, influencing strategic planning although *detailed* research planning will not necessarily outpace the overall planning system. What enables this longer-term thinking to be effective? It is the careful application of technological forecasting, which was mentioned briefly in Chapter 5. This can be a very useful and dynamic tool in R & D planning. Its effects will also condition other elements of the overall strategy, for despite its name, technological forecasting can also be used to make forward assessments in fields outside of technology—for example, social and economic activity.

A number of "futures" institutes and "think-tanks" now exist to apply the techniques to a wide range of environmental issues, and to improve the methodology.

Unfortunately, many of the supporters of technological forecasting have erected a barrier between themselves and line management. The experts have thrown up such a cloud of jargon, that their ideas and explanations are screened from the view of the uninitiated—the chief executive or manager who is expected to make use of the techniques!

In addition it is something of a current fad to stress what I call the long, long-term predictions: 20-30 years are very popular. Now some companies may require this sort of forecast, and certainly it may have value to governments, town planners and the like. But most companies require forecasts of shorter duration, which have a higher probability of accuracy. For the vast majority, the only value of the long, long-term forecast is as an academic exercise—stimulating for those taking part, but with little commercial value.

Fortunately, it is possible to get behind the smokescreen of jargon, and the methodology can be used for predictions of a shorter and more useful duration.

Technological forecasts seek to provide estimates of developments which are likely to occur in the future (some of the methods used will be explained later). The forecasts provide management with a basis for deciding which technologies are about to be overtaken by new developments, which ones are likely to have a lot of life left in them, and on which areas research should be concentrated (or abandoned) to help bring about the state of affairs which the company sees as both probable and desirable. Unfortunately, the best of the techniques still leaves management with some tough decisions—one of the most difficult being the point at which to switch to a new technology. But in the dark, even the glimmer of a candle can be very welcome, and technological forecasting rates higher than this. It can help decide research direction and priorities, and it introduces a wider range of factors into the decision process. And like all techniques, its usefulness will vary with the size and nature of the company.

A number of tongue-twisting names have been invented for the numerous methods of approach developed by the technological forecasters. Phrases like "normative relevance trees" and "morphological analysis" seem to me to confuse more than they explain and I shall try to avoid all such references in this brief outline of the methodology. It goes without saying that all methods require the participation of people who are experts in their particular field of technology.

One method, which has an obvious link with general economic forecasting, is the examination of trends and their extrapolation into the future. For example, it is possible to plot the development of a particular technology over a span of years, measuring an efficiency function on the vertical axis. It is possible to imagine such a chart plotting the development of military weapons—the efficiency index might be the weapons' destructive ability. On our imaginary graph we can plot man's first weapon, "stones", and one of his latest, "H-bombs". In between are swords, spears, bows and arrows, guns, bombs, and the like, each successive development bringing increased destructive ability, and occurring in an ever-decreasing time span. This is the past trend. The next step is to extrapolate this trend in terms of the next likely technological development and its position on the destructive ability index.

A more useful derivation of this method is to plot the capability life-cycle

curve of each individual technology, extrapolating the curves so that it becomes possible to estimate the point at which one technology is overtaken by another. The life-cycle curve will have the typical "ʃ" shape. Imagine a chart showing bow and arrow and gunpowder technologies. The first example would have a fairly short development time, the bottom of the "ʃ" curve, a relatively short climb over a relatively short period as destructive efficiency increases, and a long top of the "ʃ" lasting centuries, as peak technological development was reached. Gunpowder technology would start with a destructive efficiency somewhat below the other curve, thus for a while both technologies would overlap. For several hundred years destructive efficiency would increase, until this technology reached its peak of performance and turned the top of the "ʃ" curve.

This particular application will often reveal the turning-point of a technology's life cycle. It will not always enable management to predict exactly what will replace a technology, but may act as a warning that a replacement is probable.

The technological forecaster would be likely to supplement these extrapolative predictions with forecasts made by other methods. For example, one approach is to postulate a desirable future technological state. The forecaster then logically evaluates the alternative technological developments and routes which would be necessary in order to achieve this state. From this it becomes possible to select an R & D path. In effect, the future state is an objective, and can be seen as similar in principle to the profit objective which a company sets itself in its strategic plan, before identifying the various alternative strategic paths it might take to enable it to achieve the objective.

Some similarities with this method can be observed in the scenario approach. This postulates a number of alternative future developments for a particular technology and the intuitive judgement of experts is used to assess what implications each of these alternative futures might have on the technology in question. The method does not attempt to identify what *will* happen: only the opportunities and threats that would arise if the futures *did* happen.

One of the most well-known methods is the Delphi technique. Under this a panel of experts is selected, each independently making predictions of future developments. The method relies completely on expert intuition, for none of the members of the panel has *knowledge* of what will happen. At best, it provides an informal opinion of various possible breakthroughs and

developments and their timing. In the final event it provides management with a series of alternative futures to which it might be worth applying research effort in order to achieve them.

It is also possible to proceed in a different way. Experts are given a series of assumptions about new developments in technology, and are asked to evaluate where these would lead if they did come about. Again the results help management to decide whether the assumptions can be treated as valid research objectives, and whether their potential is likely to repay the costs of achieving them.

Yet another method calls for an exhaustive analysis to identify all the technological requirements of a product. By reconstructing these in different ways, and taking note of likely developments, it becomes possible to isolate areas for research.

The various methods all rely on the application of logical thought processes and expert knowledge and judgement to identify worthwhile areas for research and development. Because they are logical and systematic, they are likely to lead to better R & D strategies, helping the company to raise its own level of achievement. In a way, technological forecasting represents a practical way for man to gain control over his own technological progress. Because of this alone, it is worthwhile.

Improvement

The concept of a manager's duty to continually seek to increase the profitability of his operation through improved efficiency is not new. Every government from time to time exhorts industry to achieve a higher level of productivity. Every good manager will from time to time initiate special exercises to try to find better ways of carrying out certain functions. Many companies possess departments of people dedicated to improvement—value engineers, method study experts and development engineers to name a few. Some companies operate suggestion schemes in order to widen the scope of the pool from which improvement ideas are drawn.

Yet few companies really plan for improvement. In planning "improvement" I advocate the setting of profit-improvement targets to each division of the company, and creating an environment which will bring a flow of improvement projects for consideration and which will provide the necessary means of progressing and evaluating each project. It is rarely

possible for a company to produce a list of improvement schemes which will take place over the whole of the planning period. It is both possible and desirable to prepare a detailed list covering the first 1 or 2 years of the plan, quantitative targets of profit earnings through improvement for all years of the plan, and a means of converting those targets into action.

The corporate appraisal will, in many companies, provide a fund of basic things to do which will take the company some time to implement. In another situation the basic proposals may result from a consultant's report.

Thereafter, every divisional head would have the duty of meeting his improvement target and therefore producing, for his annual operating plan, a list of projects which will enable him to do this. The idea is not to cause managers to lop off necessary expenses, but to take action that will genuinely improve productivity. The principles to which they work is that standards are not lowered below acceptable limits, but that new approaches, materials, or concepts must be sought which will enable the company to meet the standards in a more profitable way.

Some may argue that this is wishful thinking. I would refute this with the example of one of the world's largest companies, Union Carbide Corporation, whose operations-improvement programme worked to pre-planned targets and was an unqualified success. The U.K. subsidiary planned and achieved an annual profit increase, brought about by doing things better, of 4% of annual operating expense (this, of course, is the profit improvement element and should not be interpreted as total annual profit growth). The U.K. company's success is described by R. Wilson in "The first five years as managing director" (*Proceedings of the Society for Long Range Planning,* May 1968–May 1969).

Why should this method of working for higher productivity be successful? Firstly, it forces management thinking out of a rut, and creates a working environment where the whole company accepts that the words "we've always done it this way" have no relevance. Secondly, it makes managers accountable: they are expected to achieve improvement results, and know what is considered satisfactory performance by top management. Thirdly, the way in which the improvement programme is presented can enable ideas to come from every corner of the company, to cut across departmental boundaries, and to foster a friendly spirit of competition.

The point is that a deliberate and planned attempt can be made to increase profits through greater efficiency, and no chief executive should neglect this

prospect when planning his long-term strategy. Improvement may not be as exciting as acquisition, but it may be a lot more sure, and may yield a much greater return on capital. There should be no strategic plan which does not meet a portion, at least of its primary objective by these means.

CHAPTER 8

A PORTFOLIO APPROACH TO STRATEGY

All of what has been stated about strategic planning has validity for organisations of all types and sizes. Diversified companies also face a further set of strategic problems which are really a need to sort out the product areas into a ranking of attractiveness, so that decisions can be made on which to develop, which to run without growth, and which to get out of.

This need to identify an investment portfolio strategy, although in this sense the resource applied may be both money and people, occurs in companies of moderate size. It reaches its zenith in the major multinational conglomerates, where the issue of product portfolio is complicated by the further problem of geographical area. And in all cases there are not only the questions of grow, stay, or divest, but also the dimensions of how big (or small) and at what speed.

Top management of such companies, after looking at the analysis in the two preceding chapters, might find that they agree in principle but do not see how it helps them solve the problems they are wrestling with. This would be a view with which I have considerable sympathy, since there is a need for a vastly different perspective at top-management level in the really complex companies. Without this it is difficult, or impossible, to issue sensible strategic guide-lines to divisions, or to know how to judge any plans put up to headquarters by the divisions.

It is also clear that such strategic issues cannot always be tackled by examining them solely within the context of the current organisational structure. There may be growth and decline products in every division, there may be overlapping of product market responsibilities (for example, the company may be tackling the same market through more than one subsidiary), or it may be that the geographical areas considered in a strategic sense should be different from the organisational structure established to

meet the geographical dispersion of the market. This does not mean that the organisation is wrong in an operational sense: merely that for strategic decisions new combinations might be necessary.

The response to these problems has been the development of a group of techniques of portfolio analysis. At the very simplest level an approach to portfolio analysis might be to rank business activities by size of profits, return on investment or cash flow, on an historic performance basis, adjusted for expected changes, and to classify this list into those which look good, those which are average and those which are poor. Cash flow can be a very good indicator for it is possible that areas with relatively low returns might, with minimum investment, yield funds which can be invested in profit-growth areas.

In many ways this simple analysis may fall short of what is needed. The classification into good, average and poor is easy to suggest, but difficult to do. It is not always a simple task to define the differences, or to overcome the emotive objections that are almost certain to be raised. It also gives little guidance about the size to which the areas should change, or the speed at which the change should be made. Despite these objections, this simple approach can work well and has been used effectively by a number of organisations.

One of the first steps to a more sophisticated analysis is to rethink the company into strategic business areas. This is a market-led exercise which may combine products which respond to different elements of the market (for example, different models of car) and geographical areas, into a relevant base for strategic decisions in relation to characteristics of the market, including competition. In this sense the relevant geographical areas for particular products might be Europe, North America and the rest: or the analysis might suggest only one area, the world.

These classifications require fairly careful considerations about what is a strategic market and what is (for these purposes) an irrelevant segment of that market. Usually they mean that the organisation has to answer questions about its activities which it should be thinking about anyway. The reconsideration of geographical areas is an attempt to think about the products in relation to their market-life cycle characteristics as well as competition. For example, in Third World countries a product may be at the start of its life cycle, and the market might be showing very different characteristics to that in the U.S.A. or Europe, where the product may be mature. The consideration of the strategic business areas in relation to market-

ing considerations brings the need for a parallel study of how the market is supplied: the end result of all the analysis should be a manufacturing strategy to support the investment strategy.

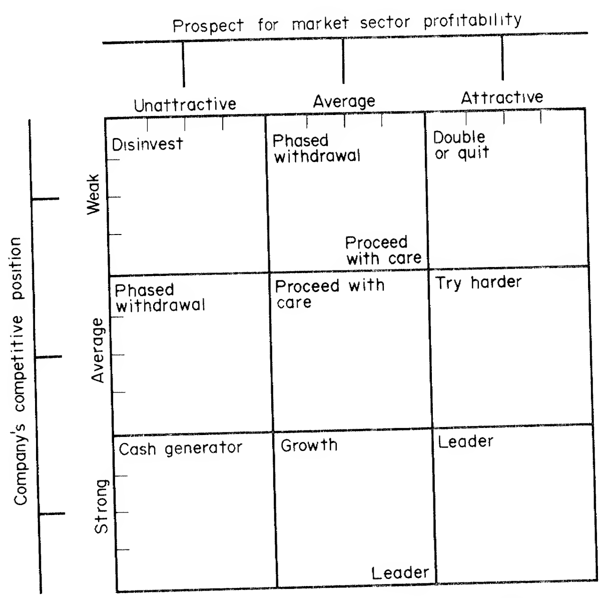
A number of techniques have been developed to help companies examine their strategies from a portfolio viewpoint. The method chosen for illustration was originally developed by Shell Chemicals and published for wider use in 1975.† In the first place it was designed for use in the petro-chemical industry, but it has been developed, modified and applied to a wide range of industry sectors.

An interesting expansion of the basic techniques was made by consultants Harbridge House. The basic technique, termed the directional policy matrix (DPM), is a two-sided matrix. Harbridge House put a third dimension to this, called Risk Matrix (RM), which has added a number of exciting possibilities.

The DPM has two axes, which attempt to encompass all the issues which are of critical importance when business prospects are evaluated. The

Fig. 16.

Example of D P.M.



† Some of the material in this chapter is based on data provided by Shell Chemicals Ltd.

horizontal axis measures prospects for sector profitability: the vertical axis examines the company's competitive capabilities. Thus it is possible to examine whether the market opportunities are good or bad, and the degree of success the company is having in those markets.

Figure 16 illustrates the matrix. Each strategic business area is plotted. The position in the matrix is the intersection of a line drawn vertically from the sector prospects axis at the point relevant to the market, and a line drawn horizontally from the competitive capability axis which measures the company's relative position. Thus if the company had a weak position in a market with unattractive prospects its position would appear in the top left-hand box of the matrix. On the other hand, a strong competitive position in an attractive market would give a plot in the bottom right-hand corner. A company with many strategic business areas can, by using this technique, plot the matrix position of each. This enables a comparison of the portfolio to be made, and the labels on the matrix provide an indication of the relevant strategy applicable for each, but more of this later.

Each axis represents a complex consideration of many factors. The method of scoring recommended by Shell gives a maximum of 12 points for each axis, but other organisations using the technique have varied this to suit their purposes. The smaller the scale, the more differentiation is possible between strategic business areas. However, the Shell system differentiates sufficiently well.

Figure 16 has been scaled in twelfths to make plotting easier. It is also divided into nine equal squares, each indicating a particular strategy. In fact the edges of these squares should be interpreted as flexible lines, since there is a need for judgement to be applied to any strategic business area which is plotted close to or on the borders of any of the nine squares. This is not a problem in practice, since the technique is not meant to be a "black box" which gives exact answers, but a way of gaining a strategic perspective which will aid decisions.

The sector prospects axis consists of three sets of factors: market growth; market profitability and quality; market supply. Each is given an equal weighting (that is each has a top score of 4 points).

Market growth is, of course, a very important determinant of prospects, and there is a lot to be said for seeking opportunities which have good growth prospects: certainly the rate of growth is relevant to investment decisions. All other things being equal it makes more sense to put new investment into areas with high growth than in areas of low growth. But other things are rarely

equal, which is why market growth is only one element considered to be important.

Scoring for the market-growth element should be made on the basis of a table, the mid-point of which is the average growth rate for the sectors in which the company is interested. An example of such a scale developed for petro-chemicals is:-

0–4% p.a.	0 points
5–7% p.a.	1 point
8–10% p.a.	2 points
11–14% p.a.	3 points
15% and over	4 points

The second element for consideration is profitability. However, what is important in a business decision is not just whether profits can be made at a high enough level, but whether consistent performance is possible, and whether there is a potential threat to performance because of ease of entry into the market or other factors. The concept may be described as market quality, and a score is reached after consideration of questions such as:

* What is the sector profitability record?
* Are margins maintained in over-capacity situations?
* Are there many customers and few producers (good), or few customers and many producers (bad)?
* How susceptible is the market to substitution by other products?
* How restricted is the technology?
* Does the market develop after-sales business (as, for example, in the spares market caused by the sale of diesel engines)?

These questions will require variation for particular businesses. Some may not be important, but there may be vital factors in some markets which should be included. It is not a difficult task to adjust the list.

The last group of factors consists of a consideration of the industry's ability to supply the market, and to match market growth. This is not only an examination of capacity, but also would embrace raw-material supplies and component availability.

Now for the other axis, the competitive position. Here, too, the axis takes account of three groups of factors of equal weighting: market leadership; supply capability; market support. Each can score a maximum of 4 points.

Market leadership is related to market share but is a little different. It is an attempt to arrive at an estimate of the degree of price leadership the company has. Thus a company in some markets may be the leader with only a 30% share, whereas in another market it may have 50% and not be the leader. Recommended classifications and scoring are:-

4 points	Leader	a company whose pre-eminent market position makes it price leader. The market share associated with this state is variable, and does not imply a majority share where there are many competitors.
3 points	Major producer	where no one company is a leader, but where there may be a number of major producers.
2 points	Viable producer	a strong viable stake, but below the top league.
1 point	Minor	less than adequate to support R & D in the long run.

Production or supply capability covers the company's own ability to support its activities in the market-place. For example, in a mechanical engineering market there may be no overall supply problems, but because of size the company may face delays and shortages of key bought-in components. Or the company may be a more economic producer than its competitors. This element is a composite of questions, such as:

* Economics of production of the company *vis-à-vis* the market.
* Capacity availability, and location in relation to the market.
* Raw material and components availability.

Again the questions should be adapted to fit the particular business.

The last component of this axis is the company's ability to give market support. This would cover product research and development, distribution, after-sales service and any other elements necessary.

Fig. 17.

Example of D.P.M.

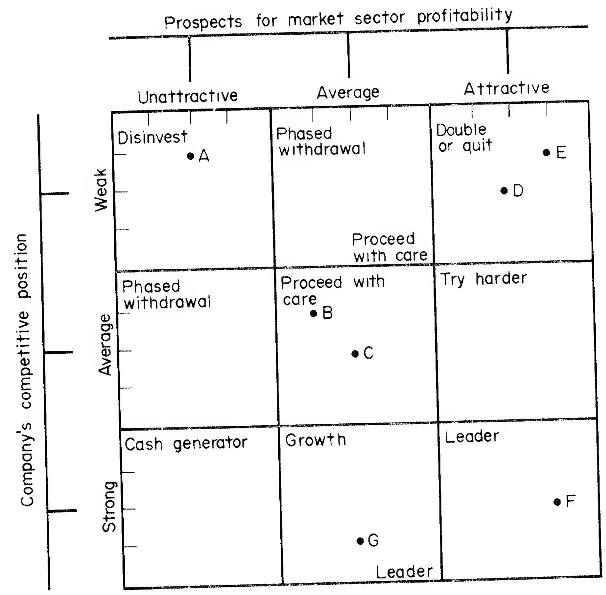


Figure 17 shows the matrix with some hypothetical strategic business-area positions filled in. Additional at-a-glance information can be provided by using different colours to indicate the relative importance of each area to corporate profits. The same result can be gained by making the area of the dot proportionate to importance, but this involves a lot of calculations to work out the appropriate areas. The hypothetical example is not meant to do anything except demonstrate the use of the method. Companies may find that their plotted positions occur in any distribution.

The meanings, and I must stress that these are indicative only, given to each box are:

* *Disinvestment*
Products falling in this area will probably be losing money—not necessarily every year, but losses in bad years will outweigh the gains in good years. It is unlikely that any activity will surprise management by falling within this area since its poor performance should already be known.

* *Phased Withdrawal*

  A product with an average to weak position with low unattractive market prospects, or a weak position with average market prospects is unlikely to be earning any significant amounts of cash. The indicated strategy is to realise the value of the assets on a controlled basis to make the resources available for redeployment elsewhere.

* *Cash Generator*

  A typical situation in this matrix area is when the company has a product which is moving towards the end of its life-cycle, and is being replaced in the market by other products. No finance should be allowed for expansion, and the business, so long as it is profitable, should be used as a source of cash for other areas. Every effort should be made to maximise profits since this type of activity has no long-term future.

* *Proceed with Care*

  In this position, some investment may be justified but major investments should be made with extreme caution.

* *Growth*

  Investment should be made to allow the product to grow with the market. Generally, the product will generate sufficient cash to be self-financing and should not be making demands on other corporate cash resources.

* *Double or Quit*

  Tomorrow's breadwinners among today's R & D projects may come from this area. Putting the strategy simply, those with the best prospects should be selected for full backing and development. The rest should be abandoned.

* *Try Harder*

  The implication is that the product can be moved towards the leadership box by judicious application of resources. In these circumstances the company may wish to make available resources in excess of what the product can generate for itself.

* *Leader*

  The strategy should be to maintain this position. At certain stages this may imply a need for resources to expand capacity with a cash need which need not be met entirely from funds generated by the product, although earnings should be above average.

The first use of the matrix is fairly clear. It is to do the strategic sorting-out job discussed earlier. The matrix may also be used to explore gaps in the portfolio. A company that has all its interests in the "leader" box is unlikely to generate sufficient cash to exploit all its opportunities: maybe its pressing need is to obtain a cash generator. A company with most of its interests in the "proceed with care box" is likely to have a pressing need to seek growth opportunities.

A third use is to evaluate competitors as well as one's own position in the market-place. (For this purpose it is possible to use the matrix to compare products instead of strategic business areas.)

Risk and sensitivity have already been discussed at some length in earlier chapters. The concept of risk was applied to the DPM in order to provide a different perspective to the portfolio. The Risk Matrix (RM) was developed for this purpose, although it is also a technique which can be used without the DPM. Used together the techniques provide a very powerful tool.

RM is another matrix which is also divided into nine equal squares. The horizontal axis is the same as that of the DPM: prospects for sector profitability. The vertical axis is very different and measures risks from the business environment.

To rate the company on this axis it is first necessary to draw an interim working matrix which lists down one side the major environmental risks faced by the company, and across the top, each of the strategic business areas. This gives a simple score sheet.

Impact			Probability	
Extremely high	6	A certainty	100%	6
	5	Very likely	84%	5
High	4	Quite possible	67%	4
	3	As likely as not	50%	3
Relatively low	2	Probably not	33%	2
	1	Highly unlikely	16%	1
None	0	Impossible	–	0

The major environmental issues may be derived from analysis, as has been suggested earlier, from brainstorming sessions with groups in the company, or by questionnaires answered by expert opinion in the company about what are the significant threats. Typically, the result will be 10–15 key issues: for

example, inflation, exchange-rate movements, energy policies, nationalisation moves in key countries and similar items.

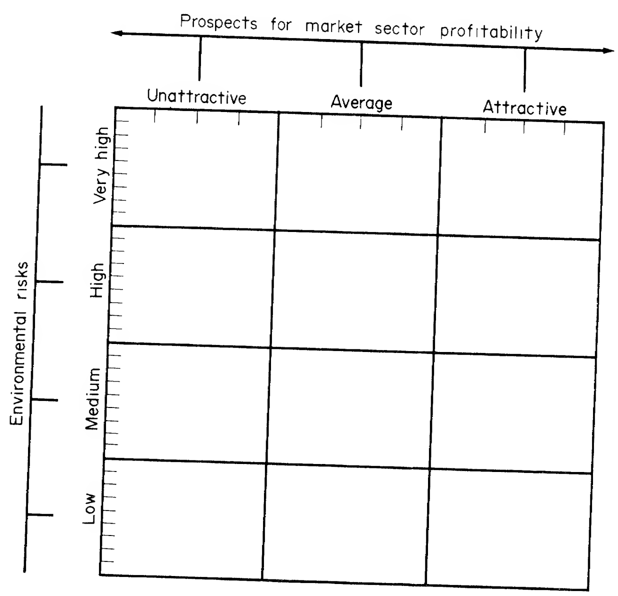
The next step is to rate each issue for impact and probability: both being scored on a range of 0–6 as described below.

Once individual ratings have been assessed, the impact score should be multiplied by the probability score giving a maximum score of 36 for each factor and a minimum of 0. Examples are:

Impact	Extremely High and *Probability*	A certainty : 6 x 6 = 36
	High	Very likely : 4 x 5 = 20
	Low	Very likely : 1 x 6 = 6

Enter these scores on the working matrix (the answers will not necessarily be the same for each strategic business area). Add the scores for each strategic

Fig. 18.
The risk matrix



Note: ratings for market prospects axis as in D.P.M.

business area and calculate an average score (divide total score by the number of relevant environmental factors). This provides an answer for each strategic business area, with a maximum possible average score of 36. The risk axis is therefore graded in the example shown in Fig. 18 in 36ths.

Using the scores for the two axes it is possible to plot a risk position for each of the strategic business areas.

Now if this is imagined as a third dimension to the matrix (impossible to draw in a usable way, but easily handled in narrative terms) it becomes possible to simultaneously perceive the DPM position and the degree of risk involved. While consideration of RM by itself may lead to strategies to reduce risk (see Chapter 5) or to a realisation that action has to be taken to adjust the company's balance of risks, an examination in conjunction with the DPM may lead to other considerations.

For example, a strategic business area which falls in a divest box may have the need for speedy action underlined if the degree of environmental risk is high. Similarly, the company ought to be aware of the increased chance of the drying up of a cash generator if this, too, is subject to high risk. A more confident investment in a growth box can be made if the risks involved are low. It may also be easier to make decisions on the "double or quit" areas if the degree of risk is assessed.

The concept of the third dimension to portfolio analysis can be used to explore other factors of significance to the company. It is possible to take a particular issue and to analyse the areas in relation to this. It may be worth examining strategic business areas in relation to energy consumption, proneness to inflation or cash requirements.

None of these tools replace management judgement, but they do help put problems into perspective. The techniques can be applied analytically as a planners' tool, although this means that they will have a good chance of being rejected in many organisations! A better approach, which leads to acceptance, is to assemble panels of senior and knowledgeable managers to make ratings for the strategic business areas which fall within the boundary of their knowledge. Such facts as can be assembled should be, for this reduces the need for assessments based on judgement and eliminates a great deal of conflict.

In order to pin down the assessments it may be of value to carry out the DPM exercise twice: once based on historic data and the other on forecasts. This helps to define the difference in perception that managers may have, and should avoid the projection of past trends willy-nilly into the future.

An extension of the panel approach is to use DPM and RM as a group technique at various levels and areas of the organisation, exploring with managers the type of data needed to carry out the analysis (and this is the same data which should be used for other aspects of planning) and discussing with the groups the degree to which their assessments match, or do not match, those of other groups. This behavioural approach is invaluable in creating involvement in planning, can be used as a vehicle for improving individual planning skills, and provides an interesting underpinning of the analyses carried out at the higher levels. Where correlation between the two is good such a use of the technique can help the company gain an understanding of the portfolio strategy adopted and a commitment to its implementation. Where it is low, it provides evidence of a difference in perception between the different levels, and the company may need to take positive action to reduce this gap. Although in theory top management can implement its portfolio strategy through its control of capital, in practice implementation of any plan requires a high degree of commitment. There is much more to strategic planning than portfolio analysis, and all the other aspects discussed in this book remain even after the portfolio strategy has been decided. The desired end product of planning is not analysis but action, for only action can lead to results.

A final word of caution should be added. Portfolio analysis techniques which lay stress on the competitive position suffer when they come up against a business area where this is unimportant. For example, however profitable horticulture or agriculture might be, the chances are that the company would score badly on the competitive axis (every producer has a minority share). The benefits of farming might be land appreciation and tax advantages which would not show clearly on the matrix.

Similarly a viable policy might be to be a small market share operator, providing an alternative for those purchasers who do not like the major market shareholder. This is, of course, more likely to be a small company strategy than a large one, and for small companies DPM is less likely to be useful. For the larger company, the DPM should offer an opportunity to question the strategy, which is not the same as assuming it is wrong.

This chapter ends with a thought that has been stressed several times. Techniques give perspective to management judgement: they do not replace it.

CHAPTER 9

FINANCIAL PLANNING

It would be very easy to begin every chapter in this book with the words "this is a critical area for the success of corporate planning". It would also be true, for every chapter covers an aspect which must be considered important if the corporate plan is to play a real part in the management and growth of the company.

Financial planning is a key activity. Everyone knows that the most exciting of development plans will only come about if it can be financed—anyone who has worked on economic development projects in an underdeveloped country will be well aware of that all too familiar taste of bitterness when a carefully developed and patently viable scheme has to be shelved because there is no capital available to implement it.

To remain in business a company has to stay solvent. It must also have sufficient liquid funds to meet its debts and to provide the means of future expansion. Lack of liquidity can bring the collapse of the most aggressive of companies.

So financial planning has three mains tasks:

* to ensure the company remains solvent,
* to ensure that it has no liquidity problems,
* to provide it with the financial resources for growth.

These are, of course, the aims of good financial management.

I believe that financial planning has two dimensions. The first is the expression of the company's plans in such a way that they positively identify the financial needs, problems and opportunities of the company. The second dimension is in the realms of strategy, ranging from the selection of a means of financing, to the management of the company's surplus funds, and through to changes in the company's general policies. Somewhere during this second process, financial planning exerts an influence on the company's Strategic

Plan: it may act as a constraint, preventing the company from taking an action that will cause a drop in current profits: it may state that project B simply cannot be financed: or it may act as a goad to stimulate further capital investment so that cash balances are reduced.

The First Dimension of Financial Planning

Before the more complex aspects of financial strategy can be considered, the company must develop a method of projecting its financial requirements into the future. Financial managers almost invariably work in the future, figuring the needs and resources of the years to come, and the financial director's office in many companies is the one place where long-range forecasts of performance may be found, and where an attempt has been made to identify future problems.

Corporate planning offers financial management a sharper tool: it replaces estimates of a purely accounting nature with firm plans and programmes of action. It therefore brings to financial management the probability of a higher degree of accuracy, a monitoring and control process that enables revision to take place where appropriate, and a method of identifying financial needs which is future-oriented, rather than based on past performance. For the well-run company, corporate planning will not introduce a system of financial planning that is revolutionary—but it will provide a method which is better.

The methods of strategic and operational planning discussed in the appropriate chapters of this book enable the company to prepare an estimate of future profits under a certain defined and detailed strategy, and with a broad picture of the capital investment that would be required to effect this strategy. Sometimes these figures will be expressed as a range, rather than one simple number, but this does not affect the value of the estimate. There will also be an estimate of that other generator of cash, depreciation, since this can be picked up in some cases directly from the operating plans, while depreciation on new investments can be calculated from the Strategic Plan.

Thus from the predetermined intentions of the other segments of the company come detailed estimates of three of the main elements of a simple cash-flow forecast—profits, capital expenditures (or capital inflows from divested assets) and depreciation. The remaining elements of the cash flow fall either within the responsibility of the financial manager himself, or the plans provide him with the mean of estimating changes in position: for example, variations in debtor or creditor relationships, inventory levels,

income from non-trading sources (including interest received), interest payable, dividends and taxation.

Two basic documents should be prepared from these data. The first is a statement of fixed and working capital requirements for each year of the long-range plan. This makes more sense if provisional priorities can be assigned to projects. In some cases, as suggested, the resultant figure will in fact be a range: in others more projects may be listed than the company will carry out—for example, the company may undertake project A requiring £50,000 investment or project B requiring £75,000, but has no intention of doing both.

The second document is a long-range cash-flow statement, giving an estimate of the financial resources that will become available, and showing these against the company's needs. In this form the cash-flow statement is a useful tool, but it can be given a still keener edge.

Some form of risk analysis should be applied (see Chapter 5) so that it is possible to see the effect on capital availability that a reduction in profits would have. If the risk analysis suggests that future profits are only 90% secure, it may be desirable to reduce the cash flow accordingly, rather than to rely on a source of funds which may not materialise.

A cash-flow statement on a yearly basis may only be a partial indicator of capital needs and availability. Most businesses have a seasonal variation of one sort or another. To ignore this can be very dangerous, since it could lead the company to under-estimate its capital needs at certain times of the year, thus running into unexpected liquidity problems.

It is necessary for an estimate to be made of constant and variable capital needs. (Constant capital is the fixed capital of the business plus that level of working capital which is needed to maintain operations in the slackest period—say for a month—of the year. Variable capital is that additional element of working capital that may be required over and above the constant level to finance the company at other periods in the year.) These will, of course, vary from business to business—the more seasonal the nature of its activities the greater will the gap between constant and variable capital become. A good system of financial planning will include a regularly revised short-term cash-flow forecast based on the annual budget. From this it is possible to calculate constant and variable capital needs for current activities: the long-range plans should provide sufficient data to enable an estimate to be made of constant and variable capital requirements over future years. These will, of course, be related to the long-range cash-flow forecast.

These estimates provide the financial planner with the raw material for the development of financial strategy. Up to this point the planning activity has been rather passive, being simply the analysis of other people's data. The next phase is more dynamic.

The Second Dimension of Financial Planning

In rare and exceptional circumstances it may be that everything adds up conveniently, and that the only financial planning required is to look at the forecasts and decide that cash inflow would equate with cash outflow, so that nothing need be done.

When making this assessment the financial planner should bear the objectives of the company in mind. A growth in earnings per share objective may inhibit the raising of capital from new share issues for example. Constraints attached to the objectives may restrict the amount of money which can be borrowed. Assuming the cash flow fits in with the objectives and constraints, and still balances within reasonable limits, he has no problem.

But this is not a likely situation. It may be that the cash flow will show an accumulation of liquid funds that will reveal a strategic problem of its own, or even more probable in an aggressive company pushing growth to the limit, it will reveal a shortfall of resources that has to be made up of borrowing or capital injections of one sort or another.

This picture in itself will be an over-simplification, since the cash flows will be based on certain policies which themselves may be changed to give a different outcome. Additionally, the picture revealed by the forecasts may not suit the overall strategy of the company, and certain changes may have to be made: for example, it may be argued that the acquisition planned for 18 months hence would be more readily financed by an exchange of shares than a cash offer. Hence it may be necessary to change financial policies to ensure that the company's own shares are in a stronger position on the Stock Exchange, and therefore more attractive to the vendor of the potential acquisition.

Many elements of the cash flow require a defined financial policy. That policy is part of the process of financial planning and will be varied to enable the company to achieve its overall objectives. It is worthwhile examining some of the areas that respond to financial planning and some of the policy changes which may result.

Working capital

The company that has a surplus of funds is often wasteful in its use of working capital. When it gets to the stage of having to borrow (particularly in times of credit squeeze, or when interest rates are high) it tends to look inwards to see how it can be more sparing in its use of money. If economies can be made, they will also have the effect of increasing the percentage return on capital, and may thus assist in meeting the company's goals in another way. Working capital may be reduced by decreasing the amount of trade credit given, increasing the amount taken, or applying more stringent control to raw material and finished product inventories. Naturally these areas are not the sole responsibility of financial management. Every operating manager has a duty to consider this aspect of company policy, and the questioning aspects of planning—for example, the corporate appraisal—may be expected to take an interest in the problem. But it is frequently the financial side of the business which focuses full attention on these policies. It is likely to be the financial manager who is aware that the cost of money has risen and that where last year it was economic to buy raw materials in extra large quantities to secure better terms, under current conditions the cost of financing the extra inventories may exceed the discount gained. Similarly, it is the financial manager who is best fitted to see when trade debtors are too high, and what action should be taken to reduce the amount of credit given.

Dividends

A company is run for its shareholders (although many would argue that it is not run for their sole benefit: there are other "stake holders" also), and the dividend policy will have an important effect on the cash-flow position. If capital is needed for growth it may be possible in the case of a private company managed by its owners to reduce dividend payments. In this case the owners are in a position to assess the chance of future earnings against present cash receipts and are qualified to take the appropriate decision. With a public company it will almost certainly be undesirable to reduce dividend levels (unless, of course, the company expects to earn a reduced level of profits). Such an action would almost certainly have an effect on the company's share price on the stock exchange. This could mean that existing shareholders would lose capital, as well as taking a reduced income. It could result in protests from shareholders—and incidentally make the company a potentially more attractive take-over fish for another company's net. The effect will

vary with the size of the decrease in dividend, and what this represents as an earnings percentage of current share price.

A decision to increase dividends may be taken—subject to government restraints—when the earnings position is so good that the board feels that it would be in the best interests of both the company and shareholders. Alternatively, such a move may be made to strengthen the company's position on the stock exchange.

Taxation

Taxation planning is a specialist subject all to itself, and one which has its own experts. (The cash-flow statement should show tax in the year of payment, not the year in which it is incurred.) The complications of tax legislation will vary in its effect from business to business, and may be particularly complex for the multi-national company which deals with the tax laws of many different countries. Fiscal incentives may affect the company expansion or diversification policies, and must be taken into account when detailed evaluation is made of projects.

The objective of taxation planning should be to ensure that the company pays only that minimum amount of tax which it is legally bound to, and no more.

In the forward cash-flow forecasts, assumptions have to be made about levels of taxation likely to apply in the future. This can be a difficult operation, and the assessments made are unlikely to always be correct. As with some of the other factors, it may be advisable to apply some form of risk or sensitivity analysis to the figures, so that the effect of an erroneous forecast can be considered.

Fixed capital

The estimates of fixed capital requirements will be rather broad, and in thinking about these the financial manager is beginning to move in the direction of his next problem—how to use the cash flow to ensure the future of the company. Nevertheless, at this early stage, it may be necessary to explore some of the options attached to the estimates. If the provisional figures suggest a tight capital position, it may be worthwhile re-examining policies about renting or buying business premises, or hiring rather than purchasing assets. In this way it may be possible to reduce the capital requirement without having to cut out investment essential to the success of the plan.

Depreciation

Within limits a company may make its own depreciation policies, and depreciation is an item of the greatest importance in the cash flow of many companies. In fact depreciation rates do vary from one firm to another—the treatment of salesmen's cars is a prime example—and an extra high or extra low rate of depreciation will have the appropriate effect on profits.

Although a cautious depreciation policy may appeal to the prudent, it is dangerous if it results in the company's assets being under-valued. Again this policy could help the company to become a candidate for a take-over bid, and could result in shareholders receiving less for their shares than is really their due. Over-cautious financial management is rarely good management.

The problem of excess liquid funds

It may be that the cash-flow forecasts will show a surplus of liquid funds over requirements, even after the adjustments made under a careful sensitivity analysis. The use of surplus capital presents a planning problem for the financial sector of the company: if the surpluses are embarrassingly large, they may represent a strategic problem. There have been cases where a company has been a subject of a take-over bid, largely because of its liquid fund position. In any event, a very high ratio of non-operating to operating capital may make it difficult or impossible for the company to earn an acceptable return on investment.

Where cash surpluses exist, whether they are moderate or excessive, it is the duty of the financial management to earn the maximum from them. The cash-flow forecasts, and the estimates of the variable capital element, provide the financial manager with a tool whereby he can assess the length of term he can afford to offer when investing his surplus funds.

The existence of surplus cash should not prevent the company from managing well, and it should be as stringent in its examination of working capital requirements as it would be in a time of financial shortage.

One thing that should not be overlooked in long-term financial planning is the possibility that an acquisition may be financed by means other than a cash purchase. This is dicussed later.

Analysis of the environment is of great importance to financial planning, whether in conditions of excess or shortage of liquid funds. Financial management must be interested in the general trends of interest rates, and in the expected position of the money market. From forecasts of general

economic health, it is but a step to assessments of the probability of the degree of credit squeeze the country might be expected to be labouring under. The financial manager should also be interested in prospects of devaluation in the countries within which he has a financial relationship. In its need to consider external factors, the financial sector of the company is no different from the other parts of the company, although the type of risks and effects to which it is subject may not be the same.

The problem of financing projects from other sources

For many companies the luxury of surplus money in the bank is a state they may dream of but will never experience. And for many it is an undesirable state, for there is a good deal to be said for gaining a larger return on shareholders' equity from the use of borrowed capital. This presumes that the company can earn more on its project than the interest it pays. (It is a very thought-provoking situation when a company earns less for its owners than if they had put their money on deposit in a building society.)

Certain elements of financial policy have to be considered before the company can plan its sources of funds. Perhaps the first is the extent of gearing which will be considered acceptable. In other words, a policy for debt/equity ratio should be laid down (unless such a policy forms one of the constraints under which the company operates, such as the previously quoted example of the company that will not consider borrowing under any circumstance).

A second area of the policy is the way in which the company will use short-, medium- or long-term financing. If the management holds the traditional view that short-term borrowing never be used to finance the purchase of fixed assets, this should be defined. Clarification of policy at this stage can save considerable wasted time at the next stage of planning.

The long-range financial plan should try to show where the funds that the company requires will come from. In normal circumstances the company has a choice between raising further equity, or obtaining a short-, medium- or long-term loan of one type or another. In every company there is an upper limit, beyond which it is unlikely the company will be able to obtain any additional finance.

In making its decisions the company will have to consider a number of factors, varying from the state of the money market to control and yield, as well as bearing in mind the company's ever-present need to maintain both liquidity and solvency.

The main factors to consider before extending the equity base of the operation are:

* The possibility of loss of control through the issue of further shares (assuming here that there are no unpaid balances on existing shares that can be called up).
* The effect on stock exchange prices which an additional share issue might have: again this could through a weakening in price lead to a loss of control.
* The particular state of the money market and the relative costs of borrowing.

Of course this is an over-simplification of the situation. A private company in a very strong and healthy position might find it advantageous to go public, and in these circumstances might so arrange things that the original owners still retain effective control.

If the plans show that major acquisitions are being sought, the company may have to be prepared to change its capital structure in order to be able to make an offer based on exchange of shares. This might be very desirable from the point of view of the vendor company, however unattractive the buyer might find it. Under current conditions cash is not always an acceptable alternative, even when the would-be buyer has sufficient liquid resources. If the acquisition strategy is really serious, the company must be willing to shape its financial strategy to suit.

There are alternatives to cash or shares as purchase consideration, varying from straight debt to convertible loan stock. The final solution can, of course, only be found in the light of the particular acquisition. What is important for the long-range financial plan is an awareness of the alternatives, the selection of priorities, and the clearing away of the difficulties that might prevent the company from implementing its preferred solution.

One maxim of greater importance to all funding-operations is that it pays to be right in the assessment of funds needed. Often it is a much simpler matter to raise one large loan than two smaller ones—for example, in many situations the obtaining of £250,000 may be an easier operation than that of raising one loan of £200,000 and another of £20,000. Raising too much money, on the other hand, may lead to additional expense. But on the whole it makes more sense to be optimistic rather than pessimistic in assessing the amounts needed. The lack of that last few thousand pounds can endanger not only the particular project but the whole company.

Sources for raising loan funds are well known. Under normal circumstances bank overdraft may be the simplest and cheapest method of obtaining working capital, particularly for a business with a seasonal rise in working capital requirements. In times of credit squeeze this source may not be so readily available. If the long-range plan shows a situation arising in the future that can be solved with a bank overdraft, there may be little for the financial director to do to prepare the ground, apart from making sure that he, the company, and the likely need are known to the various banks with whom he deals. It may be advantageous to obtain promises of support before the need arises, while he has the weapon of being able to transfer his account to another bank that might promise to be more obliging. Similarly, he may find it advantageous to divide current business between two or more banks, in order to be more flexible in the future: much depends on the size of the account. In some circumstances it may be better tactics to be a medium-sized customer of one bank than a relatively small customer of three.

Subject to exchange control regulations, it may be possible to raise a loan outside the country of operation. For example, Euro-dollars are a possible source of funds for U.K. companies.

Debentures are a traditional source of long-term debt, and tend to carry a relatively low interest rate as the risks are relatively low. There are different types of debentures that can be issued, but the success of an issue is likely to be dependent on both the standing of the company and the state of the money market. If the general rates of interest are high, debentures may be an unwise approach for the company, since to be attractive the rates of interest offered will also be high—and the company will have to continue to pay this rate over the whole period of the debenture, even though the general rates in some of these years may be lower.

Industrial medium- and long-term loans are often available from specialist undertakings.

For the company who cannot or does not wish to use these sources of funds there are others available. It may be desirable to sell and lease back industrial property, thus freeing capital hitherto locked up in land and buildings. No interest is incurred on this transaction, although a rent will have to be paid which will have its effect on the costs of production of the company's current range of output.

Some form of lease-hire may be used for certain other assets. The principle most usually applies to motor vehicles, but can be extended to items such as office furniture. A firm with a large lorry fleet could release a considerable

amount of capital by turning to lease-hire—and some companies believe that lease-hire is in any case the cheapest method of operating for them.

Additional working capital can be obtained from factoring debtors. For many this may be an expensive solution, but may be a possibility which cannot be ignored.

A company with international operations may have to think internationally when it comes to raising money. It may operate on an overdraft in Australia, and have a credit balance in South Africa. Here there is a need not only to compare interest rates against each other, but to consider legislation, government policies, and the economic possibilities of each country and its currency. It may also be easier to raise a loan in one country than in another—and some countries may have specialist industrial loan bodies which others do not possess.

The legal environment must be considered in all decisions. It is of no use to plan to obtain all your Australian subsidiaries' requirements locally, if they fall outside the borrowing restrictions imposed by the government on companies whose ownership is vested in non-Australian sources. In the U.K. there are also restrictions on the borrowing activity of the foreign-owned company. Most countries have legislation preventing the free flow of funds between international boundaries. No financial planner can afford to plead ignorance of restrictions when devising the firm's long-range financial strategy. In the worst cases he could find himself in jail: more likely the sources of funds he had planned will just not be available when the time comes, and the company may have to curtail its expansion plans or even be put in a position of poor liquidity.

The company's emerging financial strategy should also take the tool of public relations into account. It may be that from an awareness of the company's future financial position will come a realisation of the need to set particular P.R. objectives for the financial function. The company which is well known to the investing public has a better chance of success when it goes to that public for funds. Similarly the explanation for an off-trend drop in profits may be accepted by the Stock Market if the company has the right sort of image, but rejected totally if the company has no positive image at all. There may be a need to use specialist financial P.R., although this should always be linked to the company's general P.R. activities, and should not attempt to position the company as something different from the image it is trying to build up within the more general field.

Just as the cash-flow forecast assists in deciding the term for which surplus

funds can be invested, so it determines the length of time for which surplus funds may be required. Again judgement should be made after a careful sensitivity analysis. If the cash flow shows that the company will require capital only in year 2 of the plan, it makes sense to seek some form of short-term loan. To raise additional equity capital, or obtain debenture funds, would be wasteful, as in subsequent years the company would be over-capitalised. In the first case its earnings would have to be distributed over a wider base of share ownership: in the second there would be a fixed interest burden over the life of the debenture. One should not, of course, overlook in these calculations the fact that provision has to be made for interest, and for the loans themselves to be repaid!

At this stage the financial manager can complete one of the financial summaries of the strategic plan. This is the statement of capital employed (or more exactly "to be employed") for each year of the plan. Preferably this should be presented by Department, Division, or Subsidiary so that it may be used to create an R.O.I. ratio for each area of the company. The total figure should also be split into shareholders' funds and loan funds, to enable different types of R.O.I. ratios to be calculated. The statement of capital employed will build on to the current position, using the figures generated in the plan to estimate the figure for subsequent years. Theoretically this statement could have been prepared in the first stage of financial planning, along with the statement of capital requirements and the cash-flow statement: in practice, as the financial plan itself may cause changes to these figures, it is more appropriate to leave this document until last.

The final result of the financial plan should be a clear picture for management of the company's long-term capital requirements, and a detailed strategy for obtaining them. Actions that require immediate attention should be identified, and the necessary aspects of financial policy defined. Like the rest of the plan, this document becomes a part of the normal management processes of the company, and is subject to continued monitoring and revision. And on this document may depend the future success or failure of the undertaking. For unless it secures its future capital requirements the probability of a company's reaching its objectives and carrying out its strategies may be very slim indeed.

CHAPTER 10

PLANNING FOR HUMAN RESOURCES

The Need

The achievement of any set of corporate objectives requires the deployment of the two basic resources of money and people. Deficiency in either of these areas can reduce the best-laid strategy to a valueless pipe-dream.

The human resource is the most neglected of the two in the field of long-range planning. Where the limiting effects of a capital shortage are fairly easy to foresee, the constraint caused by a deficiency of human resources is not so obvious. There are many reasons for this. The quality of all money is the same, but the requirement of people has both a quality and a quantity parameter. While lack of capital may be an insurmountable obstacle, the right number of bodies can often be obtained by emergency measures—such as paying above average salaries—whatever effects this might have on corporate profitability. Perhaps, too, the problem of long-range planning in the personnel field is more complex than that of providing company capital needs. Certainly, there are some companies which have still to grasp the problem of effective personnel management in the present: those who cannot see even the problems of the moment can hardly be expected to foresee those of the future.

Worthwhile long-range personnel planning can only take place if the personnel function is regarded as a real part of the management team. The personnel department must be kept fully informed of corporate plans, since these can radically change their perception of personnel problems. A personnel department that is regarded solely as a records office, and which plays no part in management decision-making, is unlikely to be able to make a worthwhile contribution to the achievement of corporate objectives. To play an effective part in a company's future, the personnel function must of

right have a place at the management table, to dine on the full menu of information and free discussion: it should not be regarded as the child, fed on a restricted diet of what is good for it, or, worse, as the dog under the table, pouncing hungrily on the scraps and titbits of data which are thrown down to it by its masters.

To my mind, all management has a responsibility for personnel matters, and these should be considered in conjunction with the other relevant factors in any decision process. In addition, the personnel department has a particular duty for all forms of personnel planning, and the corporate planner has his usual task of making sure that planning takes place, and that it is compatible with that undertaken in other areas of the company.

Any system of personnel planning has two main facets. There is firstly the portion which appears in formal long-range plans—as, for example, the manpower plan. The second aspect is a formal approach to certain continuing problems, and consists of current procedures and systems—for example, salary administration systems and job grading.

Organisation Planning

One of the basic tasks of any manager is to organise, and a system of relationships between different people exists in all enterprises. In the smallest of businesses there may be no formal definition of these relationships. The chief executive knows everybody, himself participates in virtually every decision, and may well perform a wide range of functions personally. As companies increase in size it becomes desirable to formalise the situation, and to express the relationships in an organisation chart. There are few companies of any size which do not possess this basic planning tool.

The simplest form of organisation is the pure line. This has the benefit of simplicity, and gives unit of command. There is no doubt who the leader is. Under this system no link in the chain is omitted when passing down orders or receiving information back. As each manager has to perform all staff type tasks as part of his usual duties, the scope of management is very limited. Any company of anything but the smallest size soon finds it necessary to employ specialists to relieve managers of certain duties—for example, personnel matters. Some way of incorporating these staff relationships has to be developed, and the most commonly used form of organisation is the "line and functional" system.

In its traditional form this type of organisation chart takes a pyramid

shape, with the chief executive sitting in the apex. The symmetry of the chart may be marred by the need to accommodate advisory and service departments—thus the corporate planner may be shown clinging like a limpet to the chief executive, outside of the traditional triangle.

Within the pyramid there are lines of direct reporting relationships and, increasing in these days of specialisation, lines of functional authority. An example of the latter is the way in which a product manager may have special relationships with a sales force who do not report to him.

The purpose of the organisation plan is to aid communication, and to ensure that all reporting relationships are fully understood. This avoids the situation where Messrs. X and Y each think Mr. A reports to them—despite the impression of A that he reports to Z. In a simple organisation where, for example, the lines of authority may separate into the twin streams of production and marketing, there may be few such problems. Comparatively few companies face such a simple situation: the large firm is of necessity divided into product divisions, and may have a network of subsidiaries.

As the organisation plan fulfils a communication need, it is vital that the number of layers in the chart be reduced to as few as possible. The greater the number of layers, the more likely there is to be a blockage in communication, and the more remote from top management will the people at the bottom become. At the same time the principle of the span of control of an individual manager must be taken into account, and no person should have more people than he can control reporting directly to him. Various numbers have been suggested from time to time as the maximum in the span, and it is wrong to be dogmatic about this. In any case, the span will vary with the personal ability of each manager and the extent of use made of such techniques as operational research in the decision process. The span should be as small as possible, and I would be worried where it exceeded seven people and seriously concerned if it exceeded ten. But the right answer is affected by the nature and level of the jobs reporting to the manager, and it is unwise to be dogmatic about what is "right".

The organisation plan should also be designed to enable informal relationships to develop between people. It is often these relationships operating within the framework of the formal plan which ensure that the company remains a dynamic body.

One fault of many organisation plans is that they incorporate a number of "one over one" situations. These should be avoided. They create unsatisfactory personal relationships, do not make the best use of a manager's

ability to have more than one person reporting to him, and tend to increase the number of layers in the plan.

Organisations should, of course, be planned into logical associations of activities, and should be grouped into profit and cost centres. They should follow the principle of holding a manager accountable for his own area of responsibility, and for this reason should provide the basis for the outflow of management information, and for planning activities, including budgetary control.

If the organisation plan is to be effective, it must be accompanied by written descriptions of each manager's job. This is essential because the full scope of the task of any manager cannot be revealed from his job title and reporting relationships. (Job descriptions are also essential for many other aspects of personnel management.)

But the organisation of a dynamic company is rarely static. The company that practises the long-range planning approach will, therefore, have as great a concern for the future shape of its organisations as for the present.

In a long-range plan it is probably worthwhile producing three organisation plans: the current position, the plan for the last year of the cycle, and a plan for some convenient mid point. Of course, there is no golden rule for this, and some firms may find it necessary to look at every year of the long-range plan. The solution will depend on the rate of change predicted and the complexity of these changes.

What sort of organisation changes can be planned? Well, firstly there is the obvious one resulting from the strategic plan. If a new business venture is to be entered into, it may well cause an additional chain of people reporting to the chief executive. The strategy may well suggest the need to alter the existing structure by providing the opportunity for amalgamating established functions with the new, to give a different pattern of groupings. Expansion of activities may themselves show the need for new functions: for example, a small company with firm growth plans may have a new requirement for a market research department at some foreseeable date. Obviously changes in policy towards centralisation or decentralisation will have the inevitable effect on the shape of the organisation.

Planning of this important function goes deeper. Once the effects of the strategies have been charted, it becomes necessary to look at the task of top management. Is the burden now too large to fit the existing patterns? Or conversely, have the amalgamations of functions meant that the capacity of senior managers has been increased, so that none are fully stretched with the

result that the existing structure will become top heavy.

The human element is most important. An organisation plan is not simply a set of charts showing little boxes with job titles and names. It is concerned with people, with getting men and women to work together to fulfil some common purpose. Organisation planning must take this into consideration. People are all different, and the scope of a job may change with the person in it. This is not only that some people are more efficient than others, but that their personal skills and personality will cause changes to take place. In some cases it may become necessary to sidetrack a manager who has no potential and is blocking the promotion path of more useful executives. In others, a senior position may be kept in being for 2 or 3 years because the incumbent is due to retire: although the function will change, it may be considered inhuman to strip a man of rank and authority so near to the end of his career. Similarly, it is not socially acceptable for long-serving employees to be lightly dismissed to make way for an organisation change.

Above all, the organisation plan should aim for simplicity. A complex structure may be damaging to the company's chances of achieving its overall goals. Certainly the temptation to "Empire-build" should be avoided, and new positions should only be written into the plan when management is convinced that they are absolutely essential. Similarly when organisation changes are planned, every effort should be made to remove functions which are no longer appropriate to the business.

Organisation planning, besides plotting an important part of the management task, is necessary for many other areas of personnel management, particularly for management and manpower planning, and also for salary administration and job grading.

Management Planning

Once the organisation requirements have been extended into the future, it becomes possible to look at the way in which the company will ensure that it has the right types of people in management jobs in the future. The need for adequate top management succession planning was instanced in Chapter 4, "The Corporate Appraisal", and, of course, there is just as real a requirement to fill the other ranks of management with the right number of people of adequate quality.

A good way to look at this problem is for a management succession chart to be compiled. This records the retiring date or probable promotion date of

each manager, names one or two potential successors, and shows the ultimate level each person is likely to achieve. Where a man has no further potential for promotion, either on account of his personal attributes, or his age, this should be clearly stated. The ability to make such assessments requires a workable and fair means of rating personal performance. A succession chart should be compiled for every year into the future for which an organisation plan has been prepared.

It must, of course, be accepted that a succession chart which shows too much good material ready to be promoted, with too low a probability of movement into higher management positions, may point to a problem area. Good, ambitious managers may become restless and leave if opportunities for promotion are low. While it may be comforting to have every key position covered three or four times, it may be completely unrealistic and the company can easily find that all its best prospects have departed by the time they are needed.

The chart will also reveal gaps in succession planning. An assessment then has to be made of those gaps which must be filled with a potential successor, and those where the cost of so doing would exceed the benefits gained. Much will depend on the type of management position, the length of time the company would be likely to have to recruit an outsider, and the probability that the present incumbent will leave. The perfect state of having every position covered is simply not attainable—the company just has to decide its level of acceptable risks.

It is my opinion that these charts should be confidential to the personnel manager and top manager, and should not be reproduced in the long-range plan. What should appear in the long-range plans is an assessment of the key problems that the charts show that the company will face over the next few years, and the ways in which solutions can be found. In this part of the plan an allowance should be made for resignations and vacancies caused by death or serious illness. The larger company has an advantage over the smaller in this type of exercise, since it is likely to have a requirement for a fair number of managers of similar skills, and since it becomes easier to apply statistical techniques in the assessment of natural wastage.

The alternative management succession strategies open to a company involve recruitment, inter-departmental transfers, and training and the personal development of key people. The plan should include a statement of the policy which the company intends to enforce generally for management successions—for example, that where possible all vacancies will be filled from

within. There are very real differences between the management planning policies of companies of varying size. Where the giants of industry can expect to produce a high quota of potential top-management talent, the small company may never be able to develop such a reservoir. The family business might well have a policy of "headship" rather than "leadership", and the very top jobs might be reserved for members of the family, irrespective of their ability.

One aspect of management planning which would not be fully revealed from the organisation plans, is the changing characteristics required for management. The manager of today has to have much more mathematical ability than the manager of 15 years ago, and must be competent to cope with new techniques and concepts. A quality of management for the future is flexibility of outlook, and the ability to retrain where necessary. This is a function of mental processes, rather than chronological age, and inevitably there will always be some casualities. To make sure that the management plan is complete, attempts should be made to forecast the different types of skills that are expected to be needed in the future, and to ensure that new recruits possess the basic attributes.

Manpower Planning

Management planning only covers one aspect of the company's human resources. It is but a part of manpower planning. The other elements of manpower planning are equally important to the company's future well-being, because failure to provide an adequate work force may result in failure to achieve corporate objectives.

A good base of statistics is required. Manpower planning will usually be assisted by statistical techniques as it deals with much larger numbers than is the case with management planning in most firms.

The basic statistics required are an analysis of employee numbers by job categories and, where valid, location. The system of job classification may be a purely internal one, or it may be based on published government classifications to facilitate comparisons with national statistics. Within each category there should be break-downs by sex and age. For each of these sub-categories there should be an analysis of employees leaving the company, preferably classified by reason for leaving.

Significant conclusions can be made from this type of data. A company may find that it has an ageing labour force, and may be able to forecast

potential shortages of labour which will arise from impending retirements. Similarly, there may be groups of workers with a higher than normal resignation rate, which indicate a possible failure of the company to match up to standards and conditions of employment for this type of person.

Besides the series giving numbers of employee, there should also be a series with similar sub-headings, giving the average and range of wage rates paid. Some attempt should also be made to assess productivity increases: this is never as easy as it sounds, and often has to be based on carefully defined assumptions. The trends for the number of hours worked per unit of output, and the labour costs per unit of output, are of great importance in forecasting.

All these statistics will have more meaning if they can be compared with appropriate national and regional statistics. In many cases deviations from the external series will highlight areas of current or potential problems. It then becomes important to analyse the reasons for deviations.

Armed with these data, the manpower planner should turn to the company's strategic and operating plans, to assess how the nature of company operations is to alter over the planning period. New ventures, business expansion, and any areas which are to be closed down will have an obvious effect on future manpower requirements, and these effects should be calculated in terms of numbers of people by job category. The operating plans of various managers should be designed so that they assist this type of forecasting.

The expected increases in productivity should be forecast, partly from trends and partly from deliberate actions foreshadowed in the long-range plans.

At this stage it is possible to make soundly based forecasts of the numbers of people needed, taking all the above factors into account.

So far it has been assumed that the number of employees is reasonably constant throughout the year. In practice, there may be seasonal factors to be taken into account, and the timing of increased manpower requirements as a result of new or expanded activities may become important. In some cases monthly forecasts may be required for each of the years of the plan: in others it may be possible to quote an annual figure, merely indicating the extent of seasonal requirements as an adjustment.

This forecast will provide the company with an estimate of how many people must be available in various job categories at certain time periods. To be useful, a further forecast must be made, taking into account retirements,

death and resignation/dismissal rates, so that the company can see how many people it will have to obtain in each job category.

A further step in the planning stage is to assess how employee requirements will be met. The forecasts may indicate an area where a change in training methods would enable employees to move from one category to another. The planner must estimate how many vacancies can be filled from promotion (not forgetting to allow for the gaps caused by those promoted). By comparison with national figures it should become possible to indicate areas where recruitment will be fairly easy, and those where it may be difficult. If supplies of certain categories of labour are foreseen as becoming very tight in future, this could indicate that management action may be required to find ways of reducing demand for people of this type: for example, a tight labour situation could well lead the company to devote some of its financial resources to a search for less labour-intensive methods of production. Such a course of action could well arise as a bi-product of the manpower plan.

The manpower requirements projected may indicate a change in the types of people recruited, the decision being to obtain persons with the potential to fill positions foreseen 3 to 4 years ahead, rather than to fulfil immediate needs.

Where the plan shows a vast turnover of certain types of employee, it must also enquire why this is so, and produce a strategy to alleviate the position. For example, a department with an establishment of 50 people which had 150 different people passing through it every year would point to a very serious position. Recruiting and initial training costs would obviously be very high, and because people are always coming and going the establishment is probably set higher than needed. Part of the manpower plan must produce corrective action—and this may require a very careful study before remedies can be devised. If correction action is planned, the effects of this should be reflected in the number of people shown in the recruitment plan for future years. The study leading to the corrective strategy may concern itself with very deep issues. In some cases high labour turnover may be a function of the particular labour market, or may reflect inadequate salary scales or conditions of employment, compared with those offered by competitors. Often reasons are more complex, and require investigation of morale, employee attitudes, promotion opportunities, the company's image, and opportunities for job enrichment.

The recruitment strategy will be derived from the estimates of

requirements in the manpower plan. This plan will consider how the numbers required may be obtained. It may indicate that no specific action is required, and that there will be no difficulties in filling vacancies from the normal sources. On the other hand, it may suggest the need for specific action. Perhaps it may be necessary to use the tool of public relations to improve the image of the company in its labour-recruiting area. The company may have to begin a programme of visits to schools or universities, in order to ensure its fair share of the right type of people. Changes may be necessary in conditions of employment, in salary scales or in training methods. A decision may have to be taken to widen the catchment area for recruitment—for example, certain large employers at one stage recruited personnel direct from the West Indies.

Training

The discussion so far has touched several times on the very important subject of training and personal development. There is a need for training which stretches from top to bottom of every company, and few can afford to leave this on a haphazard basis. The importance of training has been underlined for many British companies by the industrial training legislation, with its systems of industry training boards, levies and rebates.

Many other European countries have similar systems, which really amount to a form of tax reduction for those who can prove they are giving effective training. Trade unions or the Works Council have a definite role in setting training policies in some countries.

Many of the company's future training needs will evolve from the manpower and management plans, as these will give a guide not only to the "quantity" of training required, but also to changes in the nature of training. Before a company can plan its future training, it must be sure that it fully understands its present need for training. This may indicate the need for a specific study to identify the weaknesses in current training applications, and what should be the objectives of an overall training programme.

When these steps have been taken, it becomes possible to decide on the resources which must be applied to training, and to establish an outline strategy for the period covered by the long-range plan.

In my opinion training will loom ever larger in importance in industrial life in the future. This is particularly true of management training, and the words

of Mr. G. S. Sanders, Director of the Urwick Management Centre,† are particularly relevant:

> Even today, a frighteningly high proportion of the management population continue to regard management training as some kind of desperate rescue operation to be applied only to the incompetent. Nothing could be further from the truth.
>
> Our fathers learnt one trade or skill which served them for a lifetime. It is not unrealistic to imagine that our sons may learn four in the course of theirs, and that the continuous process of re-training, of updating their knowledge in one field and acquiring new knowledge in another, will be as commonplace to them as the air they breathe.
>
> Every business executive must accept that it is his job to train his subordinate to be a better manager than he is himself. This is the only policy that works in an expanding, thriving business.

Job Grading and Salary Administration

The long-range personnel plan should rest on a foundation of a planned approach to the overall problems of personnel administration. A key factor in this approach is a system of job grading and salary administration.

When they are effectively applied, these two techniques give the company a greater measure of control over its personnel decisions. It becomes possible to adopt fairer policies for rewarding different types of jobs, the company is able to control increments, so that above-average effort receives an above-average award, but at the same time ensuring definition of the ceiling value to the company of every job. The techniques help the company to assess more readily the competitive nature of its salary structures, compared with those of other companies.

The existence of job-grading and salary-administration systems assists the company in its manpower planning. It helps in the assessment of the manpower plan in terms of pounds and pence, and it provides a basis from which to examine the organisation plan from the point of view of management succession.

Industrial Relations

Personnel planning is not simply a matter of numbers. It deals with people, and one of its most important facets is the relations between employees and management. I believe that the problem of industrial relations is so important

† From the 21st anniversary brochure of the Urwick Management Centre.

that all businesses should develop a long-term strategy for the subject. Many industries are today reaping a harvest of poor industrial relations, the seeds of which were sown many years ago by neglect of this function—the main offenders are known to all and need not be named.

The strategy will not be the same for all companies, although all are affected by the heritage of past behaviour, be this good or bad. The problems of the labour-intensive industry are different from those of the capital-intensive. Those facing the impact of a high rate of technological change, with consequent effects on the nature of jobs and the skill requirements of workers, may be subject to different pressures from those in declining industries.

In my view, all businesses need to positively identify what they are trying to achieve in industrial relations, and the steps that must be taken to bring this about. This is not a passive function. I do not believe that any company would be wise to adopt the policy of doing nothing until faced with industrial unrest—and then fighting a last ditch battle to keep the pay rise as small as possible.

To me it seems important for a company to always try to maintain the initiative in labour relations, and to always try to maintain future freedom to take the action which will contribute most to company profits. There must be many companies who look back with regret at panic concessions made to solve a past labour dispute—with the result that there is no flexibility left for the solutions to problems caused by future management strategies. When it becomes impossible for a management to install improvements which reduce manning levels, the whole country suffers.

If the strategy enables the company to take the initiative it becomes possible to plan actions which are favourable to the company, to progressively remove potential areas of employee dissatisfaction, to take deliberate steps to correct profit eroding situations (for example, low morale) and to be the prime mover in the planning and negotiation of productivity deals. It is much more sensible for management to identify improvement areas, and to start discussions on productivity deals before employees feel compelled to put in a pay claim, or to resort to strike action.

In setting its strategy, the company should define its attitude to unofficial strikes.

As with all aspects of long-range planning, the emphasis in plans should be to anticipate and remove problems, and to put the company in the best tactical situation possible at any given moment of time, so that it always

moves towards the achievement of its objectives. This does not, of course, suggest that I advocate a policy of exploitation of and meanness to employees: in fact the opposite applies, because the aim should be to identify in advance the legitimate aspirations of employees, and for everything possible to be done so that these and the company objectives are both achieved. If all companies were genuinely active in this area of long-range planning, I am sure that there would be a substantial improvement in industrial relations.

Other Elements of the Plan

There are many other factors to be considered when preparing a personnel plan. Many companies will not be in a position where they can immediately make use of all the tools of management discussed in this chapter. One major part of the long-range plan might be the planning of the steps that have to be taken to introduce, for example, a salary administration scheme into the company. Depending on the resources the company is prepared to allocate to the programme will be the length of time required to complete it. In a large company the successful introduction of such a scheme may take a number of years and, of course, a similar position may obtain in each of the other areas.

Some companies may have more basic problems. If the personnel function has been neglected in the past, there may be a large volume of basic work to complete before it is possible to move into more complex areas. There may be no basic personnel statistics—or, even worse, the detailed personnel records which form the base data for the statistics may be incomplete or completely lacking. Day-to-day terms and conditions of employment may have never been set down in detail (other than as far as is necessary to comply with legal requirements), and there may be serious anomalies in different areas of the company. It may be necessary to plan a review of conditions, or of the pension scheme, or of the welfare activities extended to employees. Over all the company will face the need to flush out problem areas, to anticipate areas that are potential trouble-spots, and to give consideration to events in the outside environment which will affect the personnel strategy. More attention may have to be given to safety and the avoidance of accidents. Environmental factors are of considerable importance, and the personnel plan should take into account such factors as the pronouncements of the government's prices and incomes watch-dog commissions on wage claims, developments in regard to trade unions, government social-welfare policies (for example, the new

earnings-related pension scheme), the pattern of industrial relations in the area and in the industry, and changing legislation on terms and conditions of employment.

The plan should assess the resources that have to be applied to personnel management in order to give effect to the strategies, and the cost of those resources. It should also assess the expected benefits of the various measures proposed.

The introduction of effective personnel planning may take time, and it may not be possible to prepare a "text-book" plan immediately. Few companies would find that their first long-range plan embraced all the facets discussed here. It is only in exceptional circumstances that the personnel planner can make one gigantic leap from the present into *total* long-term planning. But this is no reason why a start should not be made. Every new thing begins somewhere, and those who do introduce a system of planning on sound lines will find that it becomes possible to improve it with each successive planning cycle. Though plans may not have a completely professional look for some years, and although there may be vast gaps in the areas considered, the time spent on really considering the company's future in relation to its employees will be well spent. In the final event it is the thought content of the plans that count. If the only result of the plan is to bring an awareness of the importance of people to every manager in the company, and to ensure that this factor becomes a consideration in every long-term strategy, the company's total planning effort will gain in value, and its future become that little bit more secure. And this is the least that will come from personnel planning—the potential rewards are much greater.

CHAPTER 11

OPERATING PLANS

No formal planning system can be considered complete unless it includes a means of planning the established areas of the company. A strategic plan without the support of a detailed operating plan is likely to be like an engine which has not been efficiently coupled up to the machinery it is to drive. The power source will tick over merrily, but will generate as much wasted energy as it is able to use.

In Chapter 2 it was stressed that an ivory-tower approach to operational planning must be avoided at all costs, and that this can only be done by involving line management in the planning function. I can think of no circumstances where planning should be divorced from action, and I do not believe that any manager worth his salt would rest content if he were not directly concerned in the planning process. Planning is an integral part of a manager's task, and if a manager is to obtain job satisfaction he cannot have this part of his function removed from his control.

Not all ranks of management should be called upon to write a long-range plan, and those nearer the top of the pyramid will, by virtue of their particular responsibilies, be more concerned with the wider horizons of time. I believe that lower levels of management can usefully be involved to a much greater extent with short-range plans, and this fits in neatly with the possibilities of standards of performance which, too, were discussed earlier. Short-range plans, particularly the Annual Operating Plan, are a means of converting the long-range plan to action and for this reason will be discussed in greater depth in a later context.

It is worth stressing that formal planning cannot change the basic character of a manager. If he avoids decisions, the definitions of problems in depth will not cause him to alter. Really poor managers will remain poor, and indeed may seize upon the long plan as a means of delaying decisions. It is always easier to find reasons for not doing things, and it is of no benefit for

anyone to continually procrastinate. But the *really* poor manager has no place in modern business. Those managers who are made of better stuff will find that they gain a clearer understanding of what they have to achieve, and will find that a good system of planning does lead to better decisions. If they are wise, they will use the plans as a means to control those under them, just as top management will use their plans to control their performance.

Any company that practises formal planning must ask its managers to accept a mild form of discipline adherence to time-tables, taking environmental factors into account, including an agreed minimum amount of data in their plans. Most of the system of planning will be incorporated into some sort of manual, and this, too, was discussed in Chapter 2. It is now necessary to move back in time to see how the system of operational planning can be arrived at, and to give some thought to the basic input requirements of a good plan.

Designing the Framework

The new corporate planner who has to design a framework for planning has a complex task. His first step is to decide which areas of management should be required to prepare plans, and how these should be communicated to top management.

There are two basic principles which are of prime importance. The system for planning must follow lines of management responsibility, and must on no account diminish a manager's authority over his subordinates. At the same time, as many managers as practicable should participate in the planning process, and should be given the opportunity to contribute to the development of plans on a broader front than their own immediate job functions.

Consideration of these factors begins with the organisation plan: if the company does not possess such a basic document, the planner may find that his first step is to prepare one. The word "plan" was used instead of "chart", as it is the wider sphere of responsibilities which is required, rather than a set of empty job titles in little boxes.

It is my firm opinion that the basic organisational structure of the company must be well defined, if plans are to achieve any strength of purpose. To me this suggests the need for clear lines of responsibility, and the division of the company into profit and cost centres. I also believe that a prerequisite for good long-range planning is a strong budgetary control procedure.

Once these problems have been resolved—and of course many firms will already have these basic tools of management—the planner can begin to decide who should logically contribute to the planning system. The reason why this is a complex problem is that companies vary considerably in organisational structure, and the solution will be a unique one for each company. There is always at least one factor which prevents a ready-made system from being copied straight out of the textbook.

To my mind it is important that line managers down to the level of the man in charge of marketing and the man in charge of production be required to compile a formal and written plan. In addition they should have a joint role in putting together the total plan for their division, and where possible, an input into total corporate strategy. This means that the layer beneath the chief executive to which this requirement extends will vary with the type of organisation of the company. In some companies they will be the first layer reporting to the chief executive: in others—for instance, companies organised on group lines—they may be the second layer: in still other cases they could be the third or even fourth, and of course, there may be a large number of them.

Where there are more senior managers between them and the chief executive, it is important that the channels of communication be preserved. Each successive manager must discuss the plan of his subordinates, and add to it his own interpretation so that what eventually emerges is a divisional plan with which divisional management is in agreement and to which they are committed. This plan will, of course, lie within the general policy of the chief executive, and within the policy of the divisional manager. The ways in which this can be achieved will be discussed later.

Managers below the critical level of marketing and production should be involved in the planning process as much as possible. For example, a marketing manager should obtain the help of his brand managers, sales manager and any other relevant people when he prepares his plan. In some cases it may be desirable to define the contribution and to enshrine it in the planning manual. More likely, it will be necessary for the planner to establish procedures with the line manager concerned so that the required level of participation is reached. This may be achieved by personal discussion, by a more formal committee procedure, or by the use of some sort of questionnaire system so that relevant facts and opinions can be communicated to the man actually writing the plan. It is difficult to do better than arrange planning meetings on a formal basis which enable discussion of

the facts, and exploration of possible actions. Cross departmental/functional representation leads to better plans.

The final framework which is evolved has to take into account time lags. For example, the production manager cannot complete his plan until he has some idea from marketing of the sales plans for quantity, packaging, and product specifications (in turn, of course, his plan may cause a modification to the marketing plan if production costs prove higher than expected, or if he is unable to meet the required levels of production). Into the system must be built provision for the exchange of information between the different functions, so that plans can be made in a realistic way. The planner has a part to play in this co-ordinative function, but the responsibility is not solely his and is shared by the line managers themselves, and their superior, if there is one between them and the chief executive (for example, a managing director of a subsidiary). The more a planner can arrange the system so that he is not always required as an intermediary at this stage in planning, the better will the system be.

Discussion so far has centred on line departments. Staff and service departments should also be required to complete long-range plans, where this serves a useful purpose. In some cases the requirement from each department may be very simple, relating mainly to expense and manpower requirements: in others it may be complex. I consider it of great value to obtain a plan from the publicity department, if they are engaging on any form of campaign to alter or maintain the corporate image. Similarly, the computer department, with its high equipment costs and stringent personal skill requirements, must be fully involved in the planning process. In establishing the planning framework the planner must be guided by the circumstances of the individual firm: rigid rules are difficult to lay down.

Starting the Planning Cycle

Planning will not just happen. Each planning cycle must be formally started in some way, and at the same time each person in the organisation will require certain information before he can begin to plan. It is a good idea to start the process moving with a letter setting out the detailed time-tables for the cycle. The time-tables should show the dates of any meetings that are to be held, the dates for completion of various parts of the plan, the persons who should receive copies of early drafts (for example, the personnel manager will find the personnel plan easier to prepare if he has advance copies of operating plans) and the dates for review with the chief executive.

At the same time all managers will need to be informed of the assumptions on which plans are to be based, and may possibly be asked to examine particular alternative courses of action as part of their planning procedure. Assumptions are, of course, one of the means of co-ordinating management thought to a common standard.

The start-up letter must also explain the chief executive's policy and strategies for the period under review. This can be issued in the form of a series of guide-lines to each manager, and should incorporate the profit and return on investment targets which each division is expected to achieve. The letter may highlight areas of weakness in performance. Any points made must, of course, be constructive rather than destructive. The guide-lines may cover a wide range of topics—a simple example is a quantified limit on the amount of new capital that a division may be allowed to spend in the planning period.

The preliminary communication is of the utmost importance if effective plans are to be prepared. It is also important that it be sent out under the name of the chief executive, since managers should not be led to believe that the planner is dictating policy, which he should never do. If desired, the routine can be separated from the policy and it is permissible for the planner to issue the routine instructions.

The letters should pass to managers along the formal line of communication, so that each divisional head can add his own policy guide-lines to those managers under him. It is as important for these to be issued as it is for the divisional manager to receive guide-lines from the chief executive, as this can ensure that planning thought is directed to good purpose, and that subordinate managers are not frustrated through producing plans which will inevitably be rejected. The planner will often be able to help the divisional manager to prepare these guide-lines, but they must be issued by the manager and not by the planner. Time spent at this stage is of critical importance and it is good sense to derive the guide-lines from a participatory discussion between corporate and divisional management. This is, for example, illustrated in Fig. 3 of Chapter 1.

There is one further information requirement, and this is an up-to-date summary of relevant market-research data. The planner should see that before managers begin to make plans they are adequately supplied with market information. Ideally, these market summaries should be bound separately from, but issued as an appendix to, the main plan. If there is an established marketing-research function this particular aspect of planning

should fall on them. In less happy circumstances the planner himself may find that he has to fulfil this task. There will, of course, be some companies where this sort of job is already a matter of routine and in these cases the planner has only to bend the system to suit his needs. To my mind, there is a great value in planning from a known and recorded data-base, so that the facts are available to all who are concerned with plans, and the judgements of managers can be evaluated without fear of misunderstanding. Chapter 11 deals with this type of market data in greater detail.

Review of Plan

Operating plans are a line manager's means of communication with the chief executive. The planner must never act as a blockage in this channel of communication, although he has the task of ensuring that line managers have considered the future implications of their decisions, that they have studied alternative courses of action, and that their plans are achievable. He will have to fulfil his co-ordinative function of making sure that plans of different divisions do fit together. At first sight, this appears to be an impossible task if he is not to interfere with the functions of a line manager.

In practice it is possible to fulfil a good deal of this function informally, while plans are being prepared. A good planner will gain the confidence of managers, will be invited to discuss ideas, and will be given advance drafts on which he will be requested to pass an opinion. In this rather gentle way, the planner is able to put his points of view over to the line manager, and influence the shape of the plans. He should never try to be overbearing, or to force his opinions down the throats of managers.

The final plan should be given to the planner before it is seen by the chief executive. If the planner is disturbed by the content of the plan he should put his opinions to the line manager and invite him to consider them. Where agreement cannot be reached—and these occasions should be very rare—the matter should be openly put before the chief executive as the final arbiter. Such an action should be avoided if possible, as it can rupture relations between the planner and manager if either of them happen to be narrow-minded men. I have always found it possible to resolve this sort of problem informally, and am sure that the planner who has a reputation of being helpful will almost invariably be able to fulfil his duties without a formal dispute arising.

Once he is satisfied with the plan, the planner should send it on with the

plans from other divisions to the chief executive. In my opinion he should have no *secret* communication over the content of plans, although he should draw the chief executive's attention to areas which require a policy decision: for example, where two managers claim responsibility for the same function, or where a plan includes a course of action which is a departure from normal policy.

Plans should always be reviewed by the chief executive with the line manager. This can be in private interview, in which case the planner should *not* be present, unless called in during the meeting to help out with a particular problem. Alternatively, it is possible for the review to be in an open management meeting, in which case the planner should be present. The style of review chosen will vary with the company: if one method is not successful, the other should be tried. The best way is the one which suits the company. A formal review of the plan by the chief executive is essential (although the time may be reduced if adequate attention has been given to discussion at the guide-line stage). Failure to review has frequently been a contribution to planning failure.

Once a plan has been approved it becomes an instruction to the line manager to carry out the course of action intended. In turn the line manager should pass down the relevant pieces of his plan to those under him who will carry out the action.

There is one way in which the planner can save managers from future embarrassment, and this is by making sure that plans are within the resources of the division concerned. In the early stages of planning a manager may become tempted to make his plans look impressive, and may commit himself to a series of actions that he will not be able to perform. A friendly warning from the planner can often bring about a more realistic time-table.

The Use of Planning Committees

I do not believe that it is possible to plan by committee, although I accept that committees can be useful to the planner if no other established management forums exist. It is sometimes worthwhile creating special task forces to deal with particular problems, and committees may be used to discuss planning assumptions, and to review plans so that all divisions are aware of the plans of other areas of the company.

Where adequate provision for management discussion already exists, it is pointless to create additional committees. If a committee is used it must have

a well-defined task, and must exist to perform a proper job of work—a "rubber-stamp" exercise serves no purpose whatsoever.

The Features of a Good Plan

Before moving to a consideration of some of the specific requirements of operating plans, it is worth giving some thought to what makes a good plan—and of course the features of a good plan have a relevance outside of the sphere of operational planning.

Every well-prepared plan must have a purpose. There must be a reason for the plan, it should aim to achieve something. Careful attention to defining purpose can mean that management time is not diverted to irrelevant issues, or to planning a completely wrong course of action.

Fig. 19. Pro-forma budget from marketing division

(A separate sheet to be completed for each major product or operation.)

	Last Actual Year	Estimate Current Year	£'000 Plan years 1 2 3 4 5 . . . .
Sales Other Revenue [a]			
Total Revenue *Less* Cost of Goods sold			
Gross Margin			
% Gross Margin *Less* Advertising and Promotion Other Sales and Operating Expenses	( )	( )	( ) ( ) ( ) ( ) ( )
Income before Depreciation			
Less Depreciation			
Profit before H.O. Overheads and Tax			

[a] Describe separately.

Additional sub-headings should be shown where this aids planning (i.e. the main headings may be broken down into a few major sub-headings to meet the needs of each department).

There is always more than one possible course of action. A good plan will identify the various alternatives (the decision-tree technique can be useful in this context).

Reasons for selecting a particular alternative should be specified, and that course of action must be clearly defined. The plan must show how its purpose will be achieved.

The expected results of taking the course of action should be specified, so that it is possible to measure progress, and so that management is fully aware of the likely effect of the action contemplated.

Plans by themselves are useless unless converted to action. Responsibilities for performance must be clearly allocated, and there must not be doubts about who will do which task.

The Content of Operating Plans

What items actually go into the long-range operating plan will depend on the particular requirements of the company. This means that a dogmatic approach is foolish. The important thing is to motivate managers to consider the future, not to fill in forms, the requirements of which may never be varied.

Some general guide-lines can be given, for although the above statement is correct, the planner must do a little more than walk up to a manager and request him to plan. Guidance must be given of the sort of things which are likely to be relevant.

In my opinion every operating plan consists of two parts: a narrative description of the course of action planned, which might be termed the "programme", and the expected financial results of that plan, the "budget". These two elements are inseparable. If the course of action first planned does not cause an acceptable budget it is necessary to amend that course of action. The figures in the budget should never be altered just to make them appear better.

There is often some confusion about the amount of detail required in a long-range budget. As with the strategic plan, this should be distilled to as little as possible. For a marketing division, the *pro-forma* budget form shown in Fig. 19 might be used. Previous years' figures are included in this for comparison only, and the number of back years called for can easily be increased (although too much historical data can lead the company to be past-oriented, rather than future-oriented).

Depreciation is taken out separately to aid consideration of the cash-flow position, and would probably assume greater importance for a production division. The keynote of the exhibit is flexibility, and the headings must always be adjusted to suit the company.

The budget should also include another schedule which is of the utmost importance. This contains a list of new fixed capital and additional working capital requirements for each of the years in the plan. The requirements should be broken down into relevant sub-headings. For example, the requirement for new capital for the physical distribution function might be:

(i) Additional vehicles.
(ii) Replacement vehicles.
(iii) Warehouse modifications.
(iv) New Warehouses.
(v) Other items.

The requirements would be supported in the programme, and the estimated results of making the expenditures should be detailed: in other words, the chief executive must be given the opportunity of assessing the effect of *not* allowing the capital requested. Approval of this part of the plan amounts to acceptance in principle only—again, as in the strategic plan, final approval can only be against a properly evaluated proposal. The schedule enables a first allocation of future resources, identifies the future needs, and ensures that proper thought is given corporate development by every manager. Any later requests for capital which fall outside the annual and long-range plans should be treated with some severity: a blanket refusal could be against the company's best interests, but the chief executive should certainly make the manager justify his proposal in a critical atmosphere.

Discussion of the budget has really put the cart before the horse, and we should now return to the content of the programme. The suggested headings here are written as if for a division of a manufacturing company, embracing both the production and marketing functions. Adjustments can easily be made for companies organised on different lines. Companies in other types of activity—for example, transport or wholesaling—will not fit the profile without several adjustments and many additions. For these, as indeed for the companies which do fit the profile, the planner must seek answers to the question "What are the key activities of the company for which plans should be made?".

Because every plan must have a purpose, the programme should begin with a statement of the profit target, and a definition of the departmental secondary objectives. A list of goals should be given. (These concepts have, of course, already been explained in some detail.)

The programme should detail any assumptions, other than those set for the total company, on which the plan is based. Again, this is ground that has been discussed in detail elsewhere.

Each of the remaining programmes should provide separate details for each relevant area of business or product. Just what is relevant must depend on the peculiarities of each individual company. In a very complex company some amalgamation of data may be necessary in the plans submitted to the chief executive, but these should be supported by a base of sub-plans in detail which may be an internal matter between the operating manager and his subordinates.

The foremost part must be the marketing programme, since this is really what business is all about. The subject of marketing planning is so important that it is given detailed treatment in a subsequent chapter. For present purposes it is sufficient to record that a marketing programme should include the following elements:

* Marketing targets and objectives.
* A sales forecast for each of the years in the long-range plan in both value and (where relevant) defined units of quantity. Different forecasts will, of course, result from different strategies. All assumptions and methods used should be explained.
* The marketing strategy for the period of the plan should be explained in *broad outline.*
* A forecast should be made of price movements over the period of the plan.
* Problems should be anticipated where possible, and methods dealing with them defined.
* In each instance, the elements of the programme must be evaluated against the background of the market and of competition in that market.

A production programme is required to show how the goods called for in the marketing plan will be made available. This should include changes in production methods, changes in plant capacity, trends in productivity and cost of production movements. Like the marketing plan, it should endeavour

to foresee problems and either solve them at an early point in time, or take action which will avoid them.

(If the company were in the wholesaling business some form of supplies programme would be required to take the place of the production programme.)

The attention of every manager should be focused on profit improvement, and for this reason every plan should include an improvement programme, where a conscious attempt should be made to plan a course of action which will improve operations.

In my view the operating plan should also include a personnel programme, where the line manager studies his own problems of organisation and deployment of his human resources. This does not supplant the master personnel plan, although it provides useful data to be used in the preparation of this plan, and its main purpose is to emphasize the importance of the personnel element in every plan, and to reinforce what I consider a basic principle of management—that the management of people is a fundamental task of each line manager, and is not something which can be totally delegated to a personnel department.

Every operating plan should also include what I like to call a control sheet. This should show for the first and last year of the plan, significant data which can be used as a quick reference means of control. The sort of items which should be included are:

(a) Number of lorries.
(b) Capacities of plants.
(c) Number of various categories of employee.
(d) Turnover of main products and gross margins.
(e) Standard production costs.
(f) Profit contribution earned in various areas of the business.

Such a sheet is particularly useful for a company with numerous branches (for example, warehouses, chains of retail stores, etc.). It provides top management with a concise summary of what *should* be going on.

It is possible to devise systems that will produce a coherent and considered long-range plan. This is only a part of the corporate planning process, and it must not be forgotten that the plan will only become a dynamic document as it begins to produce action. The means of making a long-range plan turn into today's actions are vital to success, and are discussed in a subsequent chapter.

CHAPTER 12

MARKET PLANNING

If a company cannot sell the goods it produces at a realistic price it soon runs into trouble. It is its marketing ability which enables it to translate the needs and desires of its consumers into a formula which makes it possible for a profit to be earned. Failure in the marketing area may prevent the company from succeeding, or even lead to its complete downfall.

Like all key areas that contribute to corporate success, marketing activity responds well to the planned approach. Indeed, if the company cannot find a way of planning its marketing effort, it is very unlikely to be able to devise strategies that will be effective in taking it towards the achievement of its objectives.

There are certain common facets to both short- and long-term marketing planning. At the same time, there are vast differences of degree in the amount of detail which should go into each type of plan. The long-range plan should deal with the broader issues and concepts, should seek to adjust the company to the threats and opportunities from the environment, and should not attempt to do more than plan strategy in outline. The short-range plan, on the other hand, is concerned with getting to grips with that finer detail which enables the broad strategy to be converted to a programme for action: however, the short-term marketing plan should not deal with trivialities.

The planning of marketing effort is really a divided activity. One portion falls squarely under the heading of strategic planning, and is concerned both with giving pace to the whole organisation, and with devising the means of gaining entry into areas of business in which the company is not currently operating. A second portion can easily be seen as the task of the operating manager in planning and development of existing markets, or the extension of existing products to new markets. In practice, there is also a third area, that grey segment in the middle which it is difficult to place as solely a strategic or solely an operating task. For these the company will have to make its own

rules. The way the total task of planning is divided is not of critical importance, so long as the method adopted suits the needs of the company and the resources of management it has to bring to bear on the problem. What is critical, is that no elements of the task escape, to be neglected as being nobody's particular responsibility—and, of course, that the exact division of effort is clearly defined in the planning manual so that all managers know where they stand.

Marketing planning should be regarded as an active way of developing the company. The long-term survival of the business may depend on the aggressiveness with which the company approaches the problem of bringing innovation to its markets. The company that does not innovate is likely to be on that desolate path that leads to stagnation: it may travel on quite happily for many years, but unless it is constantly uncovering new ideas, new products, new concepts and new approaches to all areas of marketing strategy, it carries with it the seeds of its own demise. The long-range planning approach encourages the process of innovation. Flair in marketing, as in all other functions of management, is of the greatest importance: formal planning does not discourage flair, but channels it into areas which are of the greatest benefit to the company.

The Marketing Environment

The importance of the environment has been discussed in detail in several other parts of this book. It was mentioned in connection with company strategy (and therefore marketing strategy) when the theme of the corporate appraisal was developed. It appeared in the chapter on assumptions and risk, and has been drawn into the discussion on many other occasions. And, inevitably, it must be raised again in connection with the long-range planning of markets.

There is no necessity to repeat what has been said before about the need to continually study the environment in order to apply the results of the study to the strategy of the company. Marketing is, of course, probably more involved with the environmental effects than other areas of corporate strategy.

Marketing is particularly concerned with changes in the needs, desires, attitudes and opinions of its consumers. It is in this area that many forecasts have to be made if the market plans are to attempt to do more than add, in blind faith, a fixed percentage growth rate to all sales figures.

The first stage in preparing a marketing plan—be it short- or long-term—is the drawing together of the available and relevant market data, as a base on which to assess future patterns of development, and from which forecasts of market size and growth can be made. Information comes from numerous sources, and there can be few companies who know absolutely nothing about their markets. General demographic data, details of regional differences, and many other basic statistics can be obtained from government publications, and in addition there should be more specific product data from market surveys, retail audits, test market operations, sales analysis and the thousand and one other sources available to an aggressive marketing research department.

I recommend the discipline of putting these base data into a marketing handbook for each main product or family of products in which the firm deals. Such a step may not be justified for any minor products with limited potential which the company may market, but is certainly valuable for any items which the company approaches in a serious vein. Set formats should be prepared, prescribing the data headings that are considered necessary for the handbook, and these should be used for all the products. (It may, of course, be necessary to have different formats for different types of product—for example, requirements for an industrial market differ from those of the consumer market: the approach to consumer durables will vary from the approach to a fast-moving grocery product.)

Part of the handbook, the strictly factual answers to the various questions raised, can be completed by any person with access to the appropriate data: in most companies the marketing research department is an obvious candidate for the task. Inevitably there will always be gaps, where an answer cannot be given to the question raised in the handbook format. Lack of factual data should not prevent completion of the questionnaire. It is valuable for the marketing manager himself to define assumptions and make estimates to fill in these missing parts: the wise manager will probably do this in consultation with others in his team, such as the market researchers and product managers. These answers must be clearly identified as assumptions, so that they are never given a spurious accuracy. The advantage of filling in the gaps in this way is that the basis on which a plan has been prepared is defined, for there are many situations when a course of action has to be committed before all the facts are known: in reality, it is fair to claim that we never do know *all* the facts. Assumptions and estimates can also provide hypotheses for future marketing research.

Fig. 20. Broad indications of some possible data headings for the market background appendix

1. GENERAL DATA:
   - A. Population
     - age and sex
     - region
     - households
     - social class
     - urban/rural
     - working/non working
   - B. National Income
     - *per capita*
     - per household
     - regional differences
2. PRODUCT PROFILE (by relevant headings as in 1A)
   - A. Demography
     - present users
     - heavy users
     - non-users
     - competitive product users
   - B. Product Image
   - C. Analysis of Uses of Product
   - D. Time or Day of Usage Analysis
   - E. Frequency of Usage
   - F. Frequency of Purchase
   - G. Price/Volume Relationships
   - H. Brand Shares
3. DISTRIBUTION (by relevant headings as in 1A)
   - A. Source of Purchase
     - all users
     - heavy users
     - competitive product users
   - B. Brand Shares by Source of Purchase
   - C. Retailer Attitudes
     - to product
     - to company
     - to competitors
   - D. Wholesaler Attitudes
     - to product
     - to company
     - to competitors
   - E. Profitability of Product to Retailer
     - compared with all products
     - compared with competitors
   - F. Degree of Customer Service
     - given for product
     - given by competitors

G. Retailer Attitudes to
- trade packing
- consumer packing

4. MARKET SIZE (by relevant headings as in 1A)

A. Definition of Market
B. Size of Total Market
- by value
- by quantity

C. Market Forecasts
- by value
- by quantity

D. Market Size per Pack Size
E. Details of Substitute Products
F. Quantity and Value of Market by Various Channels of Distribution

5. PRICE

A. Analysis of Consumer Prices
B. Analysis of Trade Prices

6. PROMOTION

A. Advertising
- by media
- by competitor

B. Merchandising Activity
C. Special offer, etc., Activity
D. Response of Retailers to Promotions

7. MARKET SEGMENTATION

8. HISTORICAL DATA

9. PRODUCT COST DATA
- by standard costs
- by fixed and variable costs.

All these headings are indicative only. A full listing can only be made after a study of the firm's particular problems. Such a list can be prepared by any competent marketing manager. There is no significance in the order in which headings appear.

Figure 20 gives some of the broad information headings which might appear in a handbook of this nature. The important thing is that the format should be designed to meet the specific needs of the firm.

If done well, the marketing handbook can be invaluable for future planning. It will enable the marketing manager to appraise his current strategies against the real facts of the market: this self-examination, asking the question "why?", is the first step to any good planning. The handbook

shows him what information he does not really know, and makes clear where he is acting on a hunch: it ensures that where facts are available he is aware of them.

All market facts are really yesterday's news. Market planning is concerned with the world of tomorrow. The handbook is only a stepping-stone to deciding future action, and each fact should be interpreted against the trends in the environment, and the ability of the company to initiate changes in the picture revealed by the handbook.

One aspect of the important contribution that marketing research must play in the long-range planning of marketing activity has been revealed in the foregoing discussion. This contribution is the rather passive activity of collecting historical market data. Market planning also calls for a more dynamic task than this from the research department. As more thought is given to the future, so the demands on the marketing research facilities change to the provision of a different type of data. The marketing manager becomes more and more conscious of the need for information that will help him predict in advance the changing tastes of the consumer. This need is made clear by Theodore Levitt in his book *Innovation in Marketing* (Pan, 1968). He reviewed the inroads that the small car had made into Detroit's share of the U.S. market.†

> How could this unbelievable lag behind consumer wants have been perpetuated so long? Why did not research uncover consumer preferences before consumers' buying decisions themselves revealed the facts? Is that not what consumer research is for—to find out before the fact what is going to happen? The answer is that Detroit never properly researched the customer's wants. It only investigated his preferences among the kind of things which it had already decided to offer him. For Detroit was mainly product oriented, not consumer oriented.

This passage exemplifies the challenge that long-range planning offers to marketing research: it also shows the dangers that await the unwary and the complacent.

The third area on which the planned approach requires support from marketing research is in the field of marketing experimentation and the testing of new concepts. In my experience, the company that is really thinking about its future will come up with a stimulating programme of new ideas, and will become rapidly aware of a whole host of things it needs to know to progress these. If a company's marketing planning consists solely of

† From *Innovation in Marketing*, by T. Levitt, Copyright McGraw Hill Inc., 1962. Used with permission of McGraw Hill Book Company.

writing down 5-year forecasts, if it becomes a budgeting exercise that does not stretch the imagination of its marketing management, or if it becomes a repetition of the same dreary old formulae, then it will have surely failed. I have seen "planning" systems that convert everything to numbers on a form, surrounded by so many rules that the spark of individuality is destroyed, and the only result of which is to plough such a deep rut that all hope of innovation is lost forever.

A Conceptual Approach to Marketing Strategy

Both the short- and long-term plans require a minor discipline, the adherence to some form of conceptual approach to planning. This means dividing up marketing strategy into sensible headings, under which the main elements can be considered. No planner should be dogmatic about the conceptual outline he provides, for there are many ways of cutting up the total strategy. So if each marketing manager has an idea or two of his own about the way he presents his planning thoughts, I can see no good reason for opposing him. Provided the main aspects are covered, it does not really matter in which order they are set to paper.

The format I favour is the "four P's" approach based on that discussed in great detail in E. Jerome McCarthy's book *Basic Marketing: A Managerial Approach* (Irwin, 1964). The four P's are:

* Price.
* Product.
* Place.
* Promotion.

Price means what it says. It is concerned with terms of trade, discounts and price promotions. One important aspect of long-range price strategies is that some companies assume that their plans should take no account of either cost or price rises, as these cancel each other out. This, of course, is a gross fallacy, and any planner making this assumption has his head so far buried in the sand that he will never be able to give his company that quality of vision for which he was put on the payroll. In the U.K. price strategy is affected by government policies and the existence of the Prices and Incomes Board, and any proposed price increases must take these into account, as well as the effects on the market itself. Regardless of government interest in prices, no company will adjust its prices for every movement in costs: there is a tactical

position to be decided for every price rise (a supplementary reason against the use of constant prices is that this will effectively prevent the company from measuring progress against plan).

Price may, of course, be an aggressive element of marketing strategy. It may be used to change the pattern of order purchase size, thus reducing unit sales, order processing and physical distribution costs. It may be used to increase the volume of sales–Henry Ford with his cars provided what is probably the most well-known example of this strategy in practice. And of course different price strategies may be applied to export and home sales, or to the various segments of a particular market. So price must not be neglected in a company's market planning, as it is by no means a passive element which automatically compensates for inflationary tendencies.

Product is the next of the four P's. This element covers the intangible aspects of a product as well as its physical characteristics.

The tangible aspects include many different things. Perhaps the most obvious is the shape and composition of the product itself, the way in which it basically sets out to give satisfaction to its consumers. This would cover the design and finish of furniture, the taste and dietary value of a convenience food, the formulation of a toilet preparation, or the curative benefit of a pharmaceutical. Closely allied to the characteristics are the packaging and the size of unit offered for sale. Packaging is, of course, of the utmost importance in the marketing of many items: with an industrial product the main problem might be to package in a way that gives the most convenience to the user: with a grocery product the shape and appeal of the package–which may also be a vehicle to advertise special offer and promotions–may be the deciding element in the attraction of a purchaser. Packaging as a means of preserving goods from damage and storing them until sold is often second in importance to packaging as an active element of sales. There is also a cost aspect attached to each package or size of unit marketed: each additional item brings extra charges for financing inventories and storage, as well as possibly adding to direct production costs. The reduction of variety can often be an important method of planning for improved profits.

From packaging, it is natural to turn one's thoughts to branding. This element covers such items as the marketing of brands to appeal to the various segments of the market, policy for the production of "own label" products for others, and whether the company brings out families of brands, or creates a new brand for each product.

The intangible aspects of product strategy cover those items which the

company offers to purchasers as an inducement to buy. For example, the terms of credit it is prepared to give, any particular guarantees attached to the product, a special delivery service, or free after-sales servicing of appliances. With electrical goods, or motor cars, the widespread availability of service and repair shops might be a highly attractive intangible to the prospective customer.

Place is a term that calls for a little stretching of the imagination, and would be better translated as distribution (except that this word does not begin with P). The heading covers the channel of distribution chosen to get the products from the manufacturer to the consumer. This is an area which is under continual change—two examples of recent developments are the growth in the cash-and-carry wholesaling movement and the progression of vending machines, particularly for catering. Attention to this aspect of strategy ensures that the company takes full advantage of any opportunity to innovate—for example, in recent years prepacked solid domestic fuel has been successfully introduced to greengrocery outlets—and by obtaining a new method of distribution it may be possible for an increase in sales to be achieved. In addition the company must ensure that it adjusts for changes in distribution channels which are taking place in the world at large. Supermarkets are a force which have to be taken into account in the marketing of an ever-increasing range of products, although not so long ago there were still people about who rather hoped they would go away.

In planning distribution strategy, the company might well set different brand share targets for each of the alternative outlet types: it might aim for different penetration levels for each outlet. It would certainly prescribe very closely the role of wholesalers and other middlemen. And of course, the other elements of strategy, price, promotion and even product can be designed to help give effect to the chosen distribution strategy. This heading would include the way in which the sales force is to be used.

The remaining of our four P's is Promotion. This covers numerous activities in addition to the mass advertising that immediately springs to mind. Under this heading I would also include merchandising, sales promotion and point of sale activities, sampling and general product public relations. There are numerous variables to choose from, both in relation to the types of promotion used, the weights assigned to each, and the way in which the product image is put across. The forward-looking company will not have a static approach and will find considerable opportunity for development and improvement.

None of these elements of strategy exist in isolation, and to some extent each may be considered an alternative to each of the others. The number of

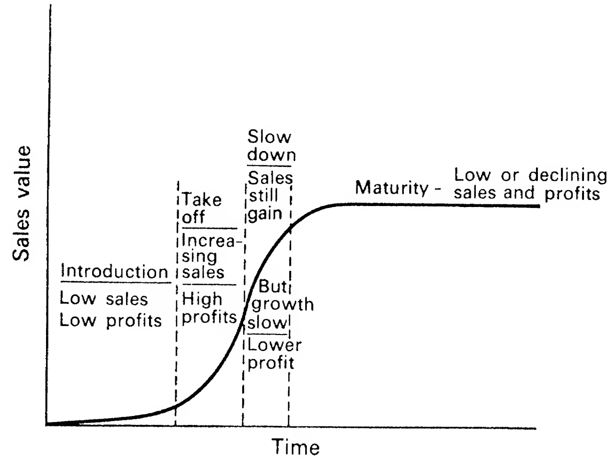


Fig. 21. Product life-cycle curve.

possible mixes is infinite. To make real sense, the entire strategy must be designed to increase profits by giving maximum utility to the consumer. It is the company which gives most consideration to this factor, which is most likely to succeed in the long term.

The conceptual approach outlined above must never be used as a repetitive exercise. Its intention is to assist the marketing manager and his assistants to free their thoughts from the shackles of what is being done today: to stimulate the imagination, not to retard it. In the final event, successful marketing planning depends not on the way the words are strung together, but on the ability and vision of the people preparing the plans. Let no one confuse the means with the end.

The Product Life-cycle Concept

One concept of importance to long-range marketing planning is the product life-cycle concept. The life-cycle theory is well known. It holds that every product begins with a period of low sales (and low profits) as it is introduced to the market. This period is followed for successful products by a

relatively short spell where sales rapidly escalate, and profits rapidly rise. The growth rate slows down as more competitive products enter the field, and as the market begins to reach saturation point. This period is usually associated with declining profitability as the established brands fight to hold their market share.

Eventually the product reaches maturity. At this point the market at best grows in line with the expansion of population: more likely it will begin to decline. With some products the end may be short and sharp: with others the product may linger on for many years, although each year that passes tends to be associated with declining profitability.

The whole process may be illustrated by the "S"-shaped curve with which many readers will already be familiar.

The product life-cycle has three important uses in market planning. It should be considered when market and sales forecasts are prepared, as skill in predicting the point where the curve begins to bend is an important ingredient in making a realistic forecast. A mathematical extrapolation taken during the period of steep growth would be vastly different from one taken after the product reaches its point of maturity. In making his forecasts the marketeer has to apply judgement to deciding the likely course of the product.

Having come to this stage, the company may find it possible to prepare a plan of action to change the predicted course of events. The market for beds might, for example, be relatively easy to predict, being largely a compound of established replacement rates and the expansion of population. In looking at this forecast, the company may decide that although it cannot do much to affect the birthrate, it can persuade the public to replace their beds more often. This must have been part of the rationale behind the recent British furniture industry advertising campaign "old furniture must go".

The third use of the concept is even more interesting. This is the planning ahead of actions to deliberately expand the uses or distribution of the product, thereby extending the product life-cycle, and postponing the inevitable day when it really does go over the hump. To my mind, this is a justification by itself of long-range market planning. By identifying the points when action must be taken to extend the life-cycle, the company puts itself in a position to direct its resources (marketing research, research and development) to finding the means to bring about the desired course of events.

A simple example is the extension of the market by introducing the

product to areas where it was not previously available. A more complex and more ingenious solution would be to seek out new uses, or new classes of user, so that the market becomes larger. An example is the introduction of a successful ethical pharmaceutical preparation to the over-the-counter trade, through chemists and grocery outlets. Another example is the efforts of the plastics industry to develop more and more uses for their raw materials. Every year that passes sees the development of the major resins for an increasing variety of products.

The Place of Forecasting

Market planning uses forecasts as a tool, and long-range forecasts of the market under different assumptions are essential if sense is to be made of plans. The techniques of forecasting were touched on in Chapter 5: obviously the more accurate a forecast can be made, the greater the potential it has for planning.

The results of all plans must also be expressed in financial terms, and the various alternatives evaluated one against the other.

Forecasting is not the be-all and end-all of planning, and a company that is truly innovating will frequently face a situation when forecasting by any scientific means is impossible. If a product is really new, no market for it may currently exist. Test marketing and other tools may be used to evaluate the potential, although in some cases decisions may have to be taken in advance of these results: a successful test marketing operation will be observed by competitors, and if the company is slow off the mark in going national, it may find that it loses that lead which may be so important to ultimate success. Even more difficult to evaluate is a change in a marketing concept. Some aspects can be measured experimentally, but others are almost impossible to tackle in this way.

Every company must ensure that it gives the innovatory ideas a fair chance. It is very easy to condemn anything new to a hades of permanent evaluation, seeking a few more facts here, a new financial calculation there, and generally making sure that initiative is stifled, and that only the tried and true ideas—the old ones—are treated seriously.

An alternative to forecasting in these impossible circumstances is to build a "model" of future expectations against which performance may be judged. It is possible to state that to be considered successful a new product (or concept) must achieve £x sales in year one, £$2x$ in year two and £$5x$ in year three. Similar parameters can be set for profits resulting from the course of

action. Now, if results as they occur are judged against these targets it becomes possible to see whether the new scheme can be considered successful or otherwise, and for corrective action to be taken at an early stage. Such a "model" can hardly justify the use of the word forecast, although it acts as a substitute and enables the company to apply planning logic to a vastly increased range of problems.

In all market planning it is important to keep in mind the possibility of the failure of a new product. National failure rates for new launches are high. Although careful attention to marketing principles and good marketing research can reduce this risk, they cannot remove it: and the more adventurous a company is, the more failures it will be exposed to. Only the senile company which has lost all courage and clings miserably to the old and secure, can be sure of avoiding product failures. This inaction carries the danger that senility eventually leads to death. As the soldier, crouched behind his barricade and afraid to lift his head to observe the enemy, will inevitably be eventually overrun, so will the firm that has lost the ability to take justifiable risks eventually succumb to the forces of change which surround it.

Those concerned with market planning will have to have more projects under consideration than their targets call for. If all were successful they would achieve better results than were required of them by the chief executive: or alternatively if the first five or seven possible launches are successful, the remaining two may be postponed. The final course of action will depend on the company's ability to handle five or seven successes in the time period available.

Physical Distribution

One important aspect of marketing that is receiving attention from up-to-date management is physical distribution (sometimes called marketing logistics). This is an area which has traditionally been neglected, and which in many companies falls organisationally under a mixture of the production, marketing and administration departments.

The tendency now is for the more advanced undertakings to subscribe to the total physical distribution concept. This holds that all elements of the physical distribution task should be identified, and considered as one total entity. Physical distribution covers all those factors which involve the movement of goods from the factory to the customer, and includes the function of storage, internal handling, loading and unloading lorries,

packaging for transport, transporting, and delivery. Taken to its ultimate conclusion this means that all these items should be placed under one overall manager, in order that they may be properly administered and controlled.

In many companies organisational patterns and accounting systems make it impossible to adopt this method of thinking unless a drastic reorganisation is made. When these problems are overcome, it can be seen exactly how much the company spends on physical distribution—and it is usually considerably more than management thinks. Too many companies see physical distribution as nothing more than the transporting function. If viewed in its proper perspective, it becomes obvious that physical distribution is a very real part of top-management strategy—and if this is so, it must respond to the planned approach. An example of the different decisions which arise from the total concept compared with the transport approach is the sort of problem that might arise from the consideration of the use of air transport. Taken in isolation a direct comparison of rates may reveal that this is the most expensive mode of transport. If the use of air freighting means that delivery times can be reduced, inventory levels lowered, branch warehouses closed down and less costly types of packaging used it may well be that far from being the most expensive method it becomes the cheapest.

In my view physical distribution is an integral part of marketing, and should not be divorced from it. Besides the fact that the overall marketing function covers the task of getting goods to the customer, some decisions under the total distribution concept are inextricably bound up with marketing strategy. Three examples will make this clear:

* Packaging, both outers and the immediate wrapping, of goods may be changed to take advantage of physical distribution economies.
* The level of customer service is both a function of physical distribution and a tool of marketing strategy.
* Price structures may be changed to encourage an increase in order size to effect a reduction in physical distribution cost.

I believe, very strongly, that physical distribution should be planned as effectively as any other aspect of marketing. It is relatively easy to provide a short guide to indicate the sort of problem which should be considered in the physical distribution plan. Unfortunately it is not possible to be so concise on how to organise these plans. The reasons are, of course, that the way in which the company runs its physical distribution function will have an impact on the way in which the plan is put together. If all physical distribution is under

the control of one man, the problem becomes relatively simple: if it is divided among several, and particularly if parts are "lost" in other functions, there may be a complex co-ordination difficulty.

What should be taken into account in planning this function?

Firstly, the planned growth in sales will show how the demand for physical distribution facilities will change. With many elements of the function the lead time necessary to implement changes is short–it may take only a few months to order and obtain extra lorries for example. Despite this, the effects should be fully analysed, for they may indicate certain actions which are necessary in the intervening years. What the plan should identify is the size and scope of the future problems the company will have to face, and it should set out a programme that will enable actions to be taken in sufficient time.

In physical distribution, as in other areas of management, there are always alternatives. The plan should seek to identify these so that the most favourable course of action can be selected. Emphasis should consistently be placed on improvement, for there are many technological developments in this field, as well as a good deal of new thinking on mathematical and other techniques of analysis and evaluation.

There are areas which are very much distribution problems, but before moving to these, it is worth considering the sort of interaction point instanced above, where maximising physical distribution efficiency would call for a change to marketing strategy. In each case a decision has to be made whether or not to alter current strategies. There will always be occasions when other marketing considerations would make it undesirable to aim for absolute physical distribution efficiency: the most suitable packaging for transport purposes may be unacceptable in marketing terms: the most economic "drop" size may only be achievable if customer service is reduced to a level which would lose sales. There is a parallel with production, for in this area, too, it is often necessary to sacrifice technical efficiency in order to manufacture the type of goods which consumers want. The important thing is for these decision areas to be identified and taken into account in the physical distribution plan: this gives the opportunity to consider the problem from a new light. And often changes to strategy can be made which will cause the company no loss of market acceptance, but which will enable the company to achieve at least a proportion of the potential economies offering. This aspect of the plan is, perhaps, less obvious than the number of warehouses, or the size of the company's lorry fleet, but in many ways it may

be more important—if only because it is often completely overlooked.

One of the major fixed capital areas of physical distribution is represented by facilities—by investment in warehouses, depots and garages. The study of the company's future may indicate an altering need for these facilities, both in terms of the volume of product to be handled and in the geographical position of areas to be served. Buildings are a relatively long-term investment, and it is not always easy to obtain additional premises in the right locations at short notice. (There is also a lease or buy alternative to be considered.) This part of the plan should be given very careful thought, and should give attention to the following points:

* modernisation of existing premises to obtain handling and storage efficiencies,
* expansion of existing facilities,
* optimum siting of warehouses,
* an answer to the question "how many depots should there be?"—in many companies a lesser number than are currently operated,
* measures to reduce inventory levels to increase the effective capacity of depots.

It goes without saying that a study should be made of the merits of operating physical distribution facilities oneself, or employing the services of specialist contractors. This is an evaluation that should be made at periodic intervals, and the outcome which will be affected by the size of demand to be put on the physical distribution section in the future, and by the nature of the firm's business.

The different patterns of the firm, as they are to emerge in the future, may also change the mode of transport used. Where rail may be suitable for product A, it may be completely wrong for the marketing strategy for product B, which the company will introduce in 2 years time.

The company which operates its own fleet of lorries has particular problems to overcome. Sales plans will give an indication of the additional quantities of goods to be moved, new areas to be served, or new types of product to be handled. From these it is possible to identify additional vehicle requirements, and, working backwards, the dates by which orders for vehicles must be placed. The problem is complicated by the need to know the type of expansion postulated. If present lorries are fully occupied an increase in sales caused by expansion in number of customers may indicate a need for more lorries. On the other hand, an increase caused by selling more goods to

existing customers may suggest that the additional capacity should come from replacing existing lorries with larger ones.

Vehicle plans cannot be considered in isolation from warehouse plans, since a change in the number of depots could affect vehicle needs. Similarly, plans must take account of changes in the environment—for example, new legislation covering safety, drivers' working hours, and general operating methods.

Changes in overall marketing strategy may affect the size of the lorry fleet. For example, if speedier delivery becomes a key part of next year's attack on the market, it may be necessary to add vehicles in order to be able to effect this.

The replacement of current vehicles must be planned, in order to provide predictions of future capital requirements, and to ensure that every replacement is seen as an opportunity for considering whether a change should be made to the specifications of the vehicle in question.

Physical distribution planning may run into a variety of other areas—use of new public carrier services (for example, a new container service overseas), training of employees, the internal handling and movement of goods, or the reorganisation of the function to achieve maximum efficiency. The needs will vary from business to business: in some companies the problem is of tortuous complexity; in others it is too simple to be believable. In every case the acceptance of the importance of physical distribution strategy as a top-management task is the key to realistic planning.

CHAPTER 13

PROJECT PLANS – CAPITAL INVESTMENT APPRAISAL

Every undertaking has a duty to endeavour to use all its factors of production to best advantage. This means that it must develop the habit of carefully scrutinising and evaluating every capital expenditure, for it is only by so doing that it can be certain that its resource of finance is being used wisely. Major projects will involve the use of the company's resources of people, and a commitment of capital to an unsound activity will also squander some of these all-important human resources. It must be a principle of good management that all resources are used carefully–and this applies whether the company is lean or fat, whether it has a small bank balance or a large one.

No system of formal planning can be considered complete unless it includes ways for treating capital expenditure decisions with the seriousness they deserve. Of course, it is quite possible for a company to apply sophisticated measures to these decisions, without attempting any other aspect of formal long-range planning. Benefits will certainly arise from such a course, but in this case they will be limited to the knowledge that the company has done all that is humanly possible to ensure that any project it undertakes is viable. The company that practises the formal planning approach shares this benefit, and has the added advantage of ensuring that the project is in the company's best interests. In other words, every capital expenditure should do something to help the company along its chosen strategic path towards its objectives.

The formal planning approach means that additional criteria–unique to the individual company–will be developed in the evaluation process. Capital should not be allocated according to emotion, the relative strengths of individual departmental managers, or to the most successful division in terms of last years' profits. Some aspects of this problem were discussed in Chapter 4 "The Corporate Appraisal".

Every business is called upon to undertake various different types of capital expenditure. Apart from normal increases in working capital arising from business expansion, the following types of expenditure can be identified:

* minor,
* replacement of existing assets,
* investment/development,
* profit improvement.

Minor Expenditures

There can be no business which does not face a host of minor capital expenditure decisions every year. In many of these the division between capital and expense may be very hazy, and the final treatment in the books may be a secret known only to the accountants. This is not important for the present analysis.

Few of these minor expenditures respond to any complicated methods of analysis. To my mind it is pedantic to consider a complex study leading to a decision such as buying a new desk, another typewriter or a projector for the training room.

What is needed for this type of expenditure is a simple system which ensures that a responsible person approves and authorises each proposal, and that a justification is given in writing in each case. Authority for approving the proposals may vest in different people: for example, a departmental manager may be given authority to approve expenditures up to £100, a divisional manager may have a limit of £1000, and all other proposals may have to be referred to the board. These limits are indicative only, and must be related to the requirements of the company.

For financial planning an estimate should be made of the likely levels of capital required for this type of project over the life of the plan.

Replacement of Existing Assets

All fixed assets of the company are liable to depreciation, and sooner or later many of them will have to be replaced. Replacement need not coincide with the life given to an asset for book depreciation, and the asset will seldom

be replaced by an identical item. The company may find it of benefit to use O.R. techniques to choose the optimum replacement times: it is more sensible to renew a piece of machinery before it begins to cause production bottlenecks, rather than attempting to close the stable door after the horse has bolted (particularly as it is not always possible to obtain immediate delivery of many items of equipment).

In all replacement situations the opportunity should be taken to evaluate the various alternatives that may be available. Firstly, the expenditure must be considered against the long-term future of the particular activity to which it refers: there is no point in spending further in an area of business which is soon to be abandoned. Secondly, it is necessary to look at the decision in the light of technological developments. This may widen the decision area, since, for example, the need to replace one particular piece of machinery may accelerate a decision to refurbish a complete section of the plant.

In some cases it may be difficult to differentiate between a replacement and another type of decision. For example, a mixture of expansion needs and technological obsolescence may lead to the building of a complete new plant and the closing down of an old one.

Replacement decisions should feature in the long-range plan. It should be possible to identify the approximate amounts of capital which will be required for these purposes during each year of the plan: this information should form part of the operating plan of each division or subsidiary in the company, and is essential for sound financial planning.

Even more important is the opportunity to identify problem areas before they occur. For example, the possibility of changing from buying to hiring salesmen's vehicles, or of altering an entire packing line because of the need to replace the filler units, should be considered well in advance of their occurrence. The planned approach should enable the company to avoid virtually all panic situations.

In many cases evaluation methods may be very much simpler for replacement decisions, although complex situations may call for more sophisticated techniques. It is not desirable to be too dogmatic over the method to be used, since a decision must be made on the merits of each individual situation. Even the simplest of replacement capital expenditure proposals should be supported by a written justification, and should follow the approval methods laid down for minor projects. The complex situations may require a detailed report, using the principles outlined later in this chapter.

Investment/Development Expenditure

Capital spent on development or new investments is perhaps the major force which enables the company to expand. In general, the two types of capital discussed above are necessary to allow the company to carry on with its current activities. It is the variety and number of new development projects which determines a company's ability to close the expansion gap revealed by the Strategic Plan.

Each of the development projects should have its place in either the Strategic or one of the operating plans. In many cases the project will be identified only in broad terms, or indeed it may be shown as one of a number of alternatives, the final choice of which still has to be made. (Examples were given in Chapter 6.) This, of course, is the ideal position, but in a real, live company there may be situations when an unanticipated opportunity arises. The method of treatment here is for the company in effect to amend its plan so that priorities are re-assigned and the effect of the new opportunity on the overall plan can be clearly seen.

Where a project is included in the long-range plans it becomes relatively easy to confirm that it is in accord with corporate objectives, and not impossible to ensure that each project is given some sort of priority rating, quite apart from its own financial evaluation criteria. The "maverick" projects are not so easily placed, and greater care has to be put into their evaluation. It is not that the techniques to judge economic viability or financial success will vary: it is simply that, particularly in a situation of scarce resources, management must be certain that the project in question does not displace another project of greater strategic importance to the company.

There is a point made elsewhere in this book that is worth repeating here. Every company should have more ideas, more projects in its plan than it can possibly fulfil. The company that is devoid of ideas, that has lost the power of innovatory thought, is unlikely to have ambitious objectives (or if they are ambitious, is unlikely to achieve them). I am always suspicious of the business whose *only* hope for expansion lies in acquisition: this may bring immediate growth, but is unlikely to give long-term development, for in the ultimate the company will stumble again over its own inability to get out of its rut.

The selection of each project becomes, in a virile company, very much a question of the choice between alternatives. More will be said on this subject later.

Profit Improvement Expenditure

It will be remembered that one aspect of corporate planning concentrates on improvement. This theme appears in the corporate appraisal, and in the improvement section of the Strategic Plan.

Many improvement projects may be carried out with no capital expenditure. In other cases the improvement can only come if an injection of capital is applied to the affected area. Return on investment on this sort of project is usually very high, often in excess of 100%.

Some improvement projects can be identified in advance, and their capital costs written into the long-range plan. By their very nature, many of these projects are not so obvious at an early stage. For financial-planning purposes it may be necessary to estimate a sum of capital to be allocated to this type of project.

Alternatives

The word "alternatives" has cropped up time and time again in this book, and a recurring theme is that one perspective of corporate planning is the identification and selection of "alternatives". In project analysis there are two phases in this selection process. The first is the choice of project, a concept which was explained in detail in the chapters on strategic planning. Secondly, there are what might be termed the internal alternatives attached to each project.

For example, the company may decide to evaluate in depth a project to expand output of a particular product. Some of the alternatives that should be considered are:

* How large an expansion to undertake.
* Whether to expand an established factory or open a new one: if a new factory is to be opened, where should it be sited?
* Whether it would be to the company's better interests to have the product made for them by another company.
* The different types of plant or variety of building that should be provided.
* Whether to buy or lease the particular items of plant and machinery required.

This list is not exhaustive. The important point is that in every situation there is *always* more than one possible course of action. The aim in project

analysis is to ensure that all realistic alternatives are considered, and the methods of analysis used should be capable of producing a quantitative comparison.

Quantitative analysis will never reveal all the answers, and should always be accompanied by a qualitative study, which would cover points such as the effect on employee morale of a particular course of action, what it will do to the corporate P.R. image, or indeed, whether it is a good or bad strategic move for the company. This qualitative analysis is a most important step in the decision process, and should not be neglected. It is always very tempting to be hypnotised by the numbers thrown up by quantitative techniques: but these never represent the ultimate solution. Business judgement is always the most important criterion in deciding what to do. No matter how good the mathematics, judgement has to be applied both in the selection of data for analysis, and in making the final entrepreneurial decisions.

Mathematical techniques are invaluable in helping the manager to come to his decision, and they also provide a standard against which performance in the future can be measured. This question of monitoring and controlling is a theme which has been discussed elsewhere in the book.

I consider it important for all major capital expenditure of this type to be supported by a comprehensive written report. Methods of quantitative analysis used should be the same for all projects–with the exception that only as much analysis as makes sense should be carried out, and that if the project does not respond to the methods chosen, the analysis procedures should be shortened. If the same method of analysis is used, it becomes easier to compare one project against another: easier, but not easy. However much the reports and analysis are standardised, there will still be variations in the quality of the assessments and judgements used in the analysis. Risk analysis can help to identify these differences, but will never entirely remove them.

Project Analysis

The best insurance a company can have that its sophisticated analysis techniques are based on well-founded data is for it to ensure that project appraisal is always approached with care. This means that objective evaluation must be made of the sources of data, and that all managers in the organisation must understand the quantitative methods of analysis used. This does not suggest that every manager must be capable of actually carrying out all the calculations personally (one can drive a car without being a mechanic), but he

must be able to interpret results. I have been involved in situations where a manager has quite cheerfully manipulated a sales forecast in order to produce the "right" d.c.f. rate: having done this he becomes convinced that the magic of d.c.f. will not let him down.

There is always a very real danger that a manager, because of personal or emotional reasons, or a firm and genuine conviction that the project is right, will not approach project analysis in an objective fashion. Bias is something that can easily creep into any investigation. Yet, in my view, a manager must play a part in investigating a project for which he will ultimately be responsible. Three steps are necessary to try to overcome this problem:

* Acceptance by all management of the principles behind the planned approach.
* Enforcing the principle of ultimate management responsibility for the recommendations made.
* Ensuring that all projects are examined by an independent assessor.

The principles of the planned approach were discussed in Chapter 2, and total acceptance of these throughout the organisation will mean that managers endeavour to be objective in all decisions. Objectivity is the badge of professional management.

Not all projects will become the eventual operating responsibility of a particular manager, although a large number of them will. Where it is possible to identify management responsibility in advance, the manager concerned must form part of the team investigating the project. He must also be made clearly aware that he is being held accountable for results. Failure of the project to come within reasonable limits of its targets will be held as his personal failure. In this way, a manager will tend to temper natural optimism with caution, and will also do his best to implement the project in the way originally intended. Where a manager is not involved, he can claim that failure is due to bad planning, rather than errors on his part, and a gulf can widen between the project report and performance.

In many cases, a project may be for something new, and at the time of investigation the company may not know who is to eventually run it. The same principle of accountability from the first stages cannot be applied here. It is well worthwhile assigning one or more experienced line managers to the project investigation team, using their capabilities as a balancing factor against a purely staff evaluation.

Every company should submit each project to an independent internal assessor. He may be an accountant, performing this analysis as part of his regular duties, the corporate planner, or a specialist project analyst. His duty is to work on the project from a fairly early stage, to question the assumptions on which the study is based, to try to ensure that all data produced are logical and that all loose ends are tidied up, to make certain that all sensible alternatives are considered and, finally, to undertake the mathematical analysis. Where the project analyst is a different person from the corporate planner, the planner too should be involved in the project, to assist in identifying alternatives, and to make sure that the project does link up with the company's overall plans and long-term strategy.

Project evaluation has a greater chance of success when it is a team effort of both staff and line managers. Like corporate planning itself, it carries an unbearable burden of disadvantage if it becomes regarded as a staff ivory-tower exercise. Both staff and line have a major part to play in the study.

Each completed report, with the recommended course of action, should go forward to the board for final decision (although this task may be delegated to a committee where the company considers this in its better interests).

The processes of project evaluation, not unsurprisingly, bear resemblance to the way in which the programme part of an operating plan is set out. All relevant aspects of the project should be studied in depth, and converted to figures which will be used in the detailed mathematical analysis. The length of time for which projections are compiled will vary with the needs of the company, and sometimes from one type of investigation to another although attempts should be made to standardise within each company. The 5-year period used in so many long-range plans will be too short for many purposes: one should always remember that the lead time for a major project will rarely be less than 12 months, and will often exceed 3 years. In the latter cases, a 5-year forecast will give very little data for analysis.

As a generalisation, I should recommend that a time-span of 10 years from the first capital expenditure be taken as the basis of mathematical analysis: this means that all forecasts must be for this period plus the lead time before the first capital expenditure. This is a recommendation which I should be prepared to change to meet special circumstances. As with the long-range plan, it is something on which each chief executive should make his own decision.

Each project will throw up special factors for investigation which are

unique to its own circumstances: similarly not all projects will require the same breadth of analysis. The following should, therefore, be interpreted only as being indicative of the scope of a project investigation.

Objective

The objective of each project should be defined and written down before the investigation begins. This should also describe the project in a few words, so that the board can swiftly grasp its scope if it becomes a firm recommendation at a later stage.

There should also be a statement showing how the project fits into the long-range plan. When the planning system is working perfectly, this may simply be a reference to the page in the long-range plan in which the project is mentioned.

Marketing

The market must never be overlooked. Marketing research should form an essential part of most major capital expenditure studies, although it is an area which is still neglected by many organisations. There can be only one excuse for failure to study the market in advance of decisions to invest in it: when the chief executive of the company considers that the costs of the research are more excessive than the likely costs of failure. In other words, each project has a limit to the investigatory expenditure it can bear, but this limit should be the result of a deliberate decision, rather than something which just happens by default. Market studies should be carried out in a way which enable market forecasts to be made.

In my view the final project report should carry a summary of market background data, but should be cross-referenced to the various survey reports for detailed facts. To attempt to show all relevant market research data in the project report would lead to a document of enormous size.

The natural step from consideration of the market is the preparation of a marketing plan. Again, if the plan is detailed it may be better to give only a short summary of the approach to marketing, keeping the main plan in a separate document. The marketing plan is an essential for any project investigation because, until it has been considered, it is difficult to produce realistic sales forecasts, or to prepare assessments of marketing and selling costs. Advertising, selling and physical distribution expenses, in particular, frequently represent a very high proportion of total costs. Care must be taken

when estimating these, if the resultant figures are to mean anything. Most people with experience of project analysis will, I think, accept that the calculations of sales volumes and costs in the marketing and selling areas are more difficult to estimate accurately than the technically based production costs. This suggests that they should receive a more determined and careful assessment in the first instance.

It may be necessary to re-examine the marketing plan at a later date. A project with a long lead time may be so far away that it is prudent to accept that many elements of the plan will change.

Physical distribution must be given particularly intense consideration, since not only does it play a vital part in the success or failure of a project, but it may also involve considerable capital investment. The importance of physical distribution will vary with the nature of the project: it needs no explanation to support the statement that the distribution of an industrial product by rail is a vastly different proposition from the distribution of beer by specialist road transport and requiring the support of a chain of warehouses.

Production

From the marketing consideration it is possible to move to the technical problems. The study should cover the way in which the product is to be made, and should include specifications of the plant and machinery and of the buildings. In many cases this is an over-simplification, and there may be a number of discussions between marketing, research and development, and production before final solutions are reached. These solutions may frequently involve modification of the original marketing requirements. For example, predicted sales volumes affect both the method of manufacture and the costs of production: the costs of production may in turn cause changes to be made in the original forecasts. This is but another instance of the circular series of relationships which have been mentioned in connection with many other aspects of planning.

It is at this point that much of the detailed data necessary for the detailed financial analysis are obtained. Raw-material costs, packaging material costs, and all the elements of direct and indirect production cost can be prepared. This requires an intimate knowledge of the processes recommended, the capital costs of the plant and buildings, the manpower levels required, and the costs of the various types of labour required. Production costs should be

calculated both on a total annual basis for financial analysis, and on a product unit basis (by fixed and variable costs) so that exercises may be carried out on the effects of increases or decreases in volume.

The complexity of analysis will vary from project to project. Technical calculations may be moderately simple where the proposal is for the expansion of an existing plant, or very, very complicated when they involve the construction of an entirely new plant, using a process of manufacture which is foreign to the company. The preparation of these estimates may involve detailed discussions with raw-material suppliers, plant and machinery manufacturers and architects. The use of consultants should be considered when this suits the circumstances of the company.

These studies are likely to result in a very large volume of reports, diagrams, charts and calculations. It is necessary that these data are clearly annotated, and considered part of the project proposal, although the actual project report should contain only a brief summary of the recommendations.

Location

Closely allied to both marketing and production factors is the siting of the project. This is not a problem when the investigation is covering a simple expansion to an existing plant. It may be very complicated when a new factory is considered, since the decision may be not only between towns but between countries as well.

The aim should be to choose a site which enables the company to produce at the highest net profit. The effects of the pull of the market, compared with the pull of the raw material sources, are described in most elementary economic textbooks, along with the other factors for consideration, such as cost and availability of land, power, water, waste-disposal facilities, labour and supporting services, and the existence of fiscal barriers or incentives. These need not concern us here.

There is a vast difference between identifying the factors in principle, and actually taking them into account in a practical study: the difficulties of breaking sales forecasts down into a regional basis are immense of themselves. In location studies it is usually good sense to make use of the appropriate O.R. techniques, and to use a computer to construct mathematical models for the analysis of alternatives. Where the company does not possess the necessary skills it may have to engage outside help. Carefully defined assumptions and the elimination of the obviously unsuitable will, in any

event, reduce the problem to a manageable size—but will still leave a tremendous volume of work if the job is to be carried out well.

There is no need to stress that the penalty for failure to obtain the best location for a factory may be a permanent additional annual expense—a sort of perpetual fine for not doing the job properly in the first place.

People

No project study can be considered complete if it ignores the human factor. There are a number of problems for consideration, all of which are simplified if the company has already prepared good long-range personnel plans: if only for the reason that some of the difficulties will have been anticipated and prepared for.

The project report should show clearly how the new proposal is to be manned. Particular attention should be paid to the key posts, but at the same time the investigators must be certain that the general manpower requirements of the project can be met.

Any effects on existing personnel—for example, if the project requires the expansion, relocation or divestment of a particular sphere of activity—must be studied and planned in detail. Additionally, any organisational changes that will be necessary must be carefully planned.

Commercial risks

Every project involves risk of one type or another. As far as possible, the commercial risks should be analysed and studied, so that top management can assess whether the rewards compensate for the dangers. An assessment of the degree of risk is important. Some of the areas which typify this sort of risk are shown below:

* Change in competitors' strategy.
* Product obsolescence.
* Loss of major export market through imposition of import controls or protective duties.
* Political events.
* Nationalisation.
* Increased government control (for example, on profit margins, or on product standards—use of cyclamates, ethical pharmaceuticals).
* Worsening labour relations in the industry.

Assumptions

At each stage in the study it will be found necessary to make assumptions to cover the unknown elements of fact. These should be recorded, and it goes without saying that they should be consistent for all aspects of the study.

Capital

One of the most important elements of any capital expenditure appraisal is the amount of capital required. This, of course, is stating the obvious. The studies described above will enable requirements to be identified, although the particular way in which these data should be presented may require a little clarification.

Estimates must be made of the two types of capital—fixed and working—required for every project. Fixed capital needs can be assessed from the studies made, and usually the majority of these needs will derive from the production elements. What may be more difficult is to identify the time when this capital has to become available. In a large project, capital expenditures may be spread over a period of several years. The project analysts need to know fairly accurately when capital is needed, as this will affect the mathematical analyses of the project, and the way in which the project will be financed.

Working capital needs will, as a general rule, tend to increase as the business expands, and can be estimated from the sales and production figures, when these are related to planned raw material and finished goods inventory levels, and to accounts receivable and payable.

One important principle is that care must be taken to identify all consequential investments arising because of management commitment to this particular project. It is grossly wrong for top management to be led to making more and more investments in order to "protect" the first one. A simple example is where the creation of a new activity may lead to an expansion in the numbers of head office staff, and a need to buy or rent additional office accommodation. One sees the same thing happening with acquisitions. To protect the new business venture, additional means are required within a year or two to modernise buildings and equipment. Or another example is the purchase of a warehouse for £*x*, when the manager knows full well that he will be back next year for another £*x* in order to modify the building to suit his real requirements. I have heard this described as the salami principle: top management is served up a slice at a time, and

never is put in a position of being able to appreciate the true shape of the sausage.

Methods of analysis

This is not a book on techniques and consequently the methods of mathematical analysis will be given only very general treatment.

Sense can only be made of a project if it is assessed on a marginal basis. No attempt should be made in the project report to allocate overheads, or other charges, that the company would bear, whether or not it made the capital expenditure under appraisal. This is not to say that *after* the investment decision is made, normal accounting practice for that company should not be followed. Similarly any additional overheads that will arise because of the new project must be charged to it.

Having said this, I should like to make the point that a project must never be looked at in isolation. An activity that is in a loss position may still be in a loss position, despite an injection of capital into an expansion project which *by itself* has a very high return on investment. If projects are always considered purely from a marginal point of view, it is very easy to overlook circumstances like this, and to end up expanding an area that should be closed, or throwing good money after bad.

Whatever methods of evaluation are used, it is essential for the company to set standards against which they can be judged. For example, an expression of a return on investment rate as, say, 15% only has real meaning if one knows within the company whether this is good or bad. The standards adopted should be the minimum that the company will find acceptable. This does not mean that all projects above this are automatically accepted, but it will ensure that–in all but the most unusual circumstances–projects falling below this rate are rejected without being put to the board. The standard set may naturally vary with both the type of project and the geographical area of the proposed investment. Thus it is quite sensible to apply a standard of, say, 15% R.O.I. for U.K. projects and 25% for African projects, where the degree of risk may be considered higher. These rates are given as examples only, and are not intended to be recommendations. The firm must set the standard itself, by reference to its long-range plans.

There are a number of ways of analysing the figures produced during the investigation. I think the first duty of any management is to accept that none of these are perfect. Some are better than others, but even these have faults.

The most prudent way is to use more than one method—and, as mentioned earlier—to season the results with a modicum of management judgement.

To my mind, the most effective methods of analysis are those using the discounted cash-flow principles. These methods enable weight to be given to the present value of money, on the basis that £1 today is worth more to the company than £1 next year, because it can earn interest on the £1 if it has it today. All the cash inflows and outflows are therefore discounted on a time basis. The rate of discounting is fixed internally by the company, but should represent the sort of return the company should be earning.

The principle can be illustrated by the following figures. At a 10% interest rate £1 will grow to £1.61 over a period of 5 years:

Year 0	£1.00
1	£1.10
2	£1.21
3	£1.33
4	£1.46
5	£1.61

It is possible, by using the reciprocal of the compound interest factor, to plot the present value of a future £1. This shows the declining present value of future money as its expenditure is postponed.

Year 0	£1.000
1	£0.909
2	£0.826
3	£0.751
4	£0.683
5	£0.621

If the chosen interest rate had been 15%, the table of present values of £1 would have been:

Year 0	£1.000
1	£0.870
2	£0.756
3	£0.658
4	£0.572
5	£0.497

The principle applies equally to inflows of cash as well as outflows.

Two methods of analysis using d.c.f. are net present value (N.P.V.) and the d.c.f. rate of return. The former seeks to measure the net present value in the

last year of the timespan chosen at the selected rate of analysis. If again, a 10% rate were chosen N.P.V. would be nil if the project equated with the standard, negative if it were below 10%, and positive if it were above it. The higher the N.P.V. the "better" the project (in purely mathematical terms).

A second criteria emerges from N.P.V. analysis, and this is the number of years before the project pays back at the discounted values. This will frequently be later than year of payback, at undiscounted values. The length of analysis affects the final answer, although the figures in the later years have less weight than those in the earlier years. For example, at 10% the discounting factor would only be 0.149 at the 20th year. This, of course, means that the larger margins of error which tend to creep in during the last years of a forecast, have less weight than the more accurate figures that might be expected in the first years.

The N.P.V. can be expressed as a d.c.f. rate of return. That is, the rate of discount that would apply to reduce the N.P.V. to nil by the last year of the analysis. Calculation of the d.c.f. rate is usually done by trial and error, but in practice can be worked out within the limits of accuracy needed after only two or three sets of calculations at different discounting rates.

D.c.f. is important because it enables taxation and fiscal incentives to be taken into account, and because it recognises that depreciation does not represent an actual outflow of cash from the firm. The method can be used in conjunction with decision trees, and also provides a basis for the quantification of risk. (Risk has been discussed in Chapter 5.)

When calculating d.c.f. it is quite simple to work out an average return on investment (R.O.I.) rate for the project, and this should be done as a matter of course. R.O.I. is an old friend, and one that still has a great deal of value in project analysis. R.O.I. and d.c.f. will frequently give different answers. A project with the same annual figure for capital employed for each year of its life might have an average R.O.I. of 10% if:

1. R.O.I. was 10% for each year, or
2. Earnings were heavier in the later than earlier years, but when averaged come to 10%, or
3. Earnings were heavier in earlier than later years.

D.c.f. analysis would indicate that situation 3 was the best project–because greater weight would be given to money earned in the present: situation 2 would come out clearly as the worst of the three.

For internal comparison of projects it is also worthwhile using return on

sales and turnover ratios. Apart from their use in comparisons between one proposal and another they also help to ensure that each project is realistic.

Financing

The last act in project analysis is to recommend the way in which the proposal will be financed. This, of course, is a direct link with the long-range financial plan, and in most cases a decision on method will have already been made. The project report provides an opportunity of checking the financial strategy for the particular project in question, and revising it where necessary.

No one should obtain the impression that a system of project analysis and appraisal, as outlined in this chapter, will automatically solve all their problems. What it will do, like every other step in the formal planning process, is to give them the chance of being right more often than they are wrong. It gives management a realistic and workable way of making a decision out of the many alternatives that confront them. And the company that chooses more wisely than its competitors is the one that is most likely to succeed in the long run.

CHAPTER 14

MAKING PLANS ACTION

Planning without action is a useless activity. It may provide a certain amount of mental stimulation, but it will not add one iota to company prosperity. In the very first chapter of this book it was emphasized that corporate planning could only be justified if it increased corporate profits. It follows, therefore, that an essential part of any planning system must be a means of making the long-range plans actually happen, of preventing them from becoming a once-a-year exercise and forcing them to be used in the day-to-day running of the company. It is fair to say that one reason why planning fails in some companies is simply that too little thought is given to this aspect.

This is not to argue a slavish attention to the letter of the plan, regardless of whether the action is still appropriate. This point has already been reasoned in earlier pages, and it is again emphasized that all plans must be flexible rather than rigid. The planning document that becomes part of day-to-day management will be flexible, since it will be deliberately adapted to changes in circumstances: throughout, the overall profit targets and corporate objectives will remain constant, and all changes will be carefully considered and evaluated. Altering a strategy is often desirable, but must never be carried out lightly and without thought.

Part of the way in which plans can become an important factor in management has been stressed time and time again. By convincing his management team that he means what he says about a planned approach, the chief executive will put planning in its proper perspective. By designing a system of planning that calls for maximum involvement from all management levels, the planner will ensure that line managers have a high degree of acceptance of planning. But these exercises in motivation are not of themselves sufficient to guarantee success. Something else is needed.

The additional factors which must be built into the planning system are:

* a means of converting long-range plans to tactical plans,

* the means of measuring progress of all types of plans,
* regular updating of plans,
* a system of personal standards of performance.

Annual Operating Plans

If a long-range plan remains in the form of a 5-, 10- or 15-year document it will be unlikely to result in action. What is required is the conversion of the first part of the plan into a short-range tactical plan—and a convenient unit with which to begin is the first year.

Within the framework of the longer term, the first year of the plan should be examined in greater detail, and an annual operating plan produced. The sort of planning cycle that I recommend is illustrated below:

February 1971	Complete 5-year plan 1972-1976
December 1971	Complete annual plan for 1972.

It can be seen from this that the annual plan is always taken in the context of the longer period and is never a document in isolation. It must reflect the strategies of the long-range plan and should never be a vehicle for the introduction of new strategies. (If a new approach is found to be necessary, the long-range plan should first be amended.) To be fully effective, the operating plan should be linked with the annual budget, and it makes good sense if the budget is seen as the expression of the operating plan in financial terms. The division of responsibility between planner and accountants must remain clear, and although there must be close co-operation and co-ordination, the budgetary control process must always remain with accounts, and should never be taken over by the planner. In concept, however, the budget should be seen as a vital part of the company's overall planning system, and not viewed as a procedure which occurs in glorious isolation.

The annual operating plan provides an opportunity of involving numerous levels of management in the planning system. While contributions to the long-range plan must be restricted to the more senior levels, with a certain amount of support from their subordinates, it is valuable to request short-range plans even from the more junior managers. There may be little point in asking a regional sales manager to prepare a 5-year plan, but a great deal of benefit may arise if he is asked to define his planned course of action for the forthcoming year.

Many of these lower-level plans need never be seen by the planner, except

in so far as he wishes to make sure that they happen, or if he is trying to help the divisional manager to improve planning at this level. In concept, the lower-level plans are a series of submissions by the more junior levels of management to their divisional manager, giving him the measure of control over his subordinates which the chief executive exercises over him. Plans at this level will require very detailed policy guide-lines from the divisional manager, to ensure that they do in fact fit in with his requirements. What the more junior managers submit to him is really a programme for the performance of elements of his plan, and the lower the level of management, the more constraints will be placed on the freedom of thought. Besides giving the divisional manager a useful means of controlling progress, this spreading of formal planning to the lower management levels can help to stimulate new ideas. At the very least they become fully aware of corporate policy, as it affects the division, because this has to be defined before they can plan.

The annual operating plans which are drawn into the total corporate plan are those of the units which contributed to the long-range operating plan—usually the subsidiaries and divisions of the company. These are the plans which are assembled for top management, to show how the strategies mapped out in the long-range plan are to be carried out. Each part of the long-range plan for the year in question should be examined in depth. Requirements for the content of plans will follow the broad headings used for the long-range plan, but will be expanded in detail. Where, for example, the long-range plan would deal with advertising in perhaps a broad policy statement, the annual plan will get down to detailed campaign objectives, media schedules and the like. The marketing plan should end up as a blue-print for the coming year's activity, set out in such detail that it could be carried out even if the marketing manager were to leave the company.

Operating plans should be prepared in advance of the budget. Having set out beforehand the course of action intended, it is possible to prepare the budget to show the financial results. If these results do not take the company to its targets, it becomes necessary to re-examine the operating plan. The budget figures should never be judged to give the correct answers, unless a change is made to the total plan. In this way the operating plan gives the budget much more meaning than is the case in many companies, because the need for any policy changes becomes fully apparent. Any changes must, of course, be seen in the context of the long-range plan and actions outside of the long-range strategy will only be taken if the long-range plan is amended so that the full implications are appreciated.

In practice, some parts of the organisation will have to begin planning before others. Sales forecasts are needed before costs of production can be ascertained, while the production costs themselves may alter marketing strategy. This is the familiar reiterative effect which occurs with all planning activity, and which has been encountered in this form in the long-range planning system. In fact, little difficulty occurs once a system of planning is in operation, and provided the company has a reasonable management-information system, since the marketing people will have sufficient knowledge of the company's pattern of costs to set strategies and forecasts which will need little or no amendment once the final budget costs are calculated.

Each annual operating plan and budget should be reviewed by the chief executive with the manager concerned. As with the long-range plans, the planner should have sight of them before they move higher, so that he can exercise the same co-ordinative function which he exercises over the long-range plans. He has some particular additional duties to perform in the case of the annual plans—to make sure that actions in the annual plans do not cut across long-range strategy, and to see that elements of strategy set out in the long-range plan are not omitted from the appropriate tactical plan. It is very easy to "lose" the odd course of action, and although no company should fulfil a plan which time has made inappropriate, no course of action should be abandoned by default.

In many ways the production for getting good annual operating plans are similar to those for getting good long-range plans. Planning assumptions must be defined, and any necessary policy guide-lines issued by the chief executive. Profit targets should be the same as those used for the appropriate year in the long-range plan. A comprehensive time-table should be issued by the planner, to ensure that every person involved understands the part he has to play, and the date by which his contribution must be received. This time-table should envelop that of the accountants operating the budgetary control system, so that the two parts are seen as a composite whole. Sufficient time must be given for reconsideration of both budgets and plans, in case the first results produced do not come up to expectations.

These methods should ensure that the first year of the long-range plan is converted to a firm course of action.

Other Tactical Plans

The annual plans will not be the only tactical plans required. Within the

annual operating plan, there may be elements which should be isolated and for which a specific programme for action should be completed. In some cases these elements may cover a part of the year: in others they may overlap the planning year (for example, the building of a new factory).

These types of tactical plans often benefit considerably from the application of some of the techniques discussed in Chapter 5. Network diagrams are particularly useful for many of these plans. In many cases simple schedules and bar diagrams are sufficient. Sometimes, where each step will reveal alternatives for decision, a decision tree is useful. Whatever techniques are used, the main steps in this type of tactical planning must be the isolation of each task or event to be performed, setting a date for performance, and ensuring that responsibility for performing each stage is assigned to an appropriate individual. Whether the plan is for test marketing a new product, installing new machinery, or simply changing the location of the office, these methods will make sure that management's intentions become action, in a way that is positive and controllable.

Monitoring Performance

The tactical plans set out the intentions of the long-range plan in a way which makes action possible. Responsibility for action is assigned to individuals, and the task they have to perform is defined. In most cases, they will also be aware of the effect that failure in performance by them will have on the rest of the company.

Once again, the chief executive has a problem to face. How can he make sure that actions are being carried out? The only answer is to have a system of monitoring and follow up. If an action is scheduled in the plans, the chief executive is entitled to expect that it will be performed: if the various individuals in the company know that a monitoring system exists, they will be less likely to fail for trivial reasons, since their sins will come home to roost.

The first part of the controlling procedure comes from the budget. Regular comparisons of performance against plan, and analysis of variance, give the direction in which the company is moving, and it is possible for each manager to see how close he is to his profit targets, and to take action to correct disadvantageous situations. The principles of budgetary control are, of course, well known as a management tool and need no further discussion here.

What *is* important is recognition that the budgetary processes are not by

themselves sufficient to ensure that the plan is being carried out. The right result can often be obtained for the wrong reason, and the budgetary processes may not necessarily reveal this. At the last moment a manager may take action which is against long-term interests in order to get the profit figure "right"—the figures may disguise this. Most important of all, there may be actions which have to be taken which are essential to future plans, but which have no separate identifiable effect which can be measured by the budgetary control processes.

Something else is needed. This is a means of monitoring the operating plan itself, of making sure that actions are completed on due data, and that their effect is recorded. Some part of this was discussed when objectives and goals were considered, and setting out the plans in quantitative terms, with action time-tables, eases the monitoring task. Perhaps the simplest way of monitoring is for a list of items due for completion to be abstracted from each plan at regular time intervals, and sent to the relevant operating managers with a request that they report on progress, and explain any failures. If desirable, the planner may omit items which he knows have been successfully completed. In many companies a quarterly monitor is sufficient, although it may be more frequent, and in any event a separate check must be made on an *ad hoc* basis on any major single actions which will have far-reaching effects if not carried out to schedule. Although the planner may prepare the list, it is to my mind absolutely essential that the monitoring letters be signed and sent out by the chief executive. It is he who is most concerned with a plan's progress, and it is important that managers realise that it is he who is going to be upset by a failure, not the planner. Alternatively, a company with a good committee system could arrange for these items to be placed on the agenda of appropriate meetings.

All operating managers should be taught by the planner to accept that plans may be changed if the course of action scheduled turns out to be a wrong one. There is no failure by the manager, if he does change, provided all effects are fully evaluated, and any long-term results taken into account. The blackest of all sins is when an action goes by default, when a manager fails to fulfil an obligation, or changes a course of action without knowing that he has changed, or why he has done so. The chief executive must be prepared to show his displeasure at this sort of behaviour—and in any well-run company, the knowledge that such displeasure will be shown is enough to make managers avoid such embarrassing situations.

No one in the company will fail to understand that the planner plays a

part in initiating the review procedure, and the planner would be unwise to try to pretend that the abstract does not begin with him. If replies are sent direct to the chief executive this should remove some part of any impression that the planner is disciplining managers. The rest of any feeling which might build up can often be removed very simply. Where a planner is aware that an action of major importance is coming up for monitoring and has not been carried out, he can improve his own relationship with the line manager by giving him an informal warning. This will at best give the manager a chance to perform the action: at worst he will be able to advise the chief executive of his failure, and give a new completion date, before he is requested for such an explanation. This, of course, puts the manager in a much better light.

One thing the planner should never do is to try to influence the chief executive in the way he treats managers who ignore their plans. This is a matter which should be private between the chief executive and the offending manager. The chief executive must, of course, be aware that performance is of the greatest importance to successful planning, and that he has put this fact over to all his managers as part of his normal duty of activating management.

Monitoring the progress of plans does not end with the annual operating plan, and a similar procedure should be devised for any short-term plan. In this case the chief executive may not always be involved (the extent of his involvement will depend on the importance of the particular plan). Generally it is sufficient for the group or working party responsible for implementing the plan to appoint one of their number to make regular progress reports at defined intervals. Alternatively, he may be charged with the duty of exception reporting—bringing the working party's attention only to events which did *not* proceed to plan.

It is important for rescheduling to take place in any form of monitoring procedure. The new dates and courses of action should be integrated into the existing plan, and the chain effect on other parts of the plan must be taken into account.

The third type of monitoring procedure that should be instituted deals with a different type of plan, the project plan. Many companies make very comprehensive investigations into capital expenditure appraisals, but few have any follow-up procedure to compare their studies with what really happens once the capital is spent. Some form of monitoring capital projects is important, to make sure that top management's wishes have been carried out, to ensure that no further action is required by management to bring the

situation back to plan, and to improve planning ability in the future. The last reason is of greater importance than is often imagined. Many lessons can be learnt through a study of mistakes, and any project study is subject to a large number of areas for potential error.

The elements of a project proposal which require monitoring include the time span for implementation, the actual capital spent, and the results actually achieved. The comparison must, of course, do more than state variances, it must show the reasons for them. Management can learn no lessons from knowing that certain key forecasts are wrong, unless it knows why they are wrong.

It follows that if results are to be monitored, the accounting system must present them in such a way that comparison is possible. This may not be difficult in a multi-million pound project involving the construction of an entirely new factory for the company. It is not so easy when the project involves the modifications of existing plant, or where the capital is spent on a function which is indistinguishable from operations already being carried out. In extreme cases the total results may be immeasurable in practicable terms, and management may have to be informed of this—but even in these cases it will be possible to measure certain aspects, such as additional personnel employed and the capital spent.

It is also impracticable to think about measuring results for each of the years included in the original proposal—be they 5, 10, 15 or longer. Some compromise is necessary, and it is suggested that this should be to carry out a full comparison of results against the proposal, at the end of the first full year's trading. At this stage a comparison is likely to be worthwhile, and to yield results which will be helpful to the business. What is equally important is that it may not be too late for management to take corrective action if events are not proceeding to plan. If all is well, this may be the only monitoring action that is needed, and the project may then be considered as a true part of company operations which will fall within the overall planning arrangements of the company. It may, however, be desirable to continue monitoring results for the next few years, and this will be essential if the project is one which is expected to yield a loss for a number of years. The final decision will depend on the particular project—obviously the major new chemical works deserves more management attention than the new warehouse, although in a dynamic situation it will soon be impossible to monitor effectively because the business will grow, and will call for additional investment which will change the shape of the original project.

Updating Long-range Plans

The planner has to face another problem when he designs a planning system. It has been stressed that plans must be flexible, that strategies may require amendment if objectives are to be achieved. It has also been suggested that a continuous study of the environment is an essential part of any long-range plan, and that a change in environmental factors and basic assumptions may make an alteration to strategy an essential: indeed, the ability to alter course to turn events in the outside world to a company's advantage has been given as one of the basic reasons for corporate planning. So far the changes that have been suggested will occur at irregular intervals, and will be outside of the normal planning cycle. There can be no doubt that replanning a part or the whole of the plan in these circumstances is an essential, and must be carried out if the document is to continue to have meaning.

What may also be desirable is the regular updating of the financial results of the long-range plan, as an integral part of the corporate planning system. Some companies revise all these results as a matter of routine at 6- or 3-monthly intervals, on the grounds that this forces managers to correct for the thousand and one small developments, which might otherwise slip by until the beginning of the next full planning cycle. In theory, this system always gives the chief executive a clear idea of what his company is to achieve over the 5-year period (or whatever time span is fixed for the long-range plan), corresponding in a way to the "latest estimate" which may appear for the year on a normal budgetary control system.

The difficulty with this concept is that it becomes very difficult for participants in the planning process to be objective. It is too easy for the expected results of the next 5 years to be influenced more by last week's sales, or yesterday's strike, than by deliberate policy changes. Theoretically, constant updating keeps a manager aware of the long-range plan, and ensures that current decisions are made against the longer-term strategy. In practice, it can easily become a meaningless chore. Unless a manager is able to divorce himself from day-to-day activities when he makes these alterations to plan, they can, in fact, be dangerous. Where the complete process of preparing a long-range plan forces a manager to devote several days to thinking about the future, the partial revision at regular intervals may be dismissed as a 10-minute job.

This is not to say that regular updating will never serve a purpose. Much depends on the managers in the company—if they are competent to tackle

such a system, and sufficiently versed in planning knowledge to understand the flexibility of mind which such a system calls for, then it can be of great value. In my opinion it is a development which can only rarely be successfully introduced in the early years of planning, but which may well be one of the refinements to the system which can come as the company as a whole becomes better at planning. In many cases I suspect that this should not be until the third year of planning, at the earliest.

Personal Standards of Performance

The use of standards of performance—possibly broadening into "Management by Objectives"—has already been discussed at length. In this context it is stressed that the personal standards provide one means of converting plans to action, by identifying the key contribution which individual people have to make, if annual plans are to be achieved. This breaks down the overall responsibility for certain aspects of the plan, which might be held by a particular manager, into units which can be used to motivate the various people under him. In this way, it is more likely that plans will become action, and it is also possible to pinpoint more of the true reasons for any failure in performance which may occur.

Yearly Report on Planning

The measures outlined so far are enough to drive the plans forward to results. There is one other step which should be taken, both to improve overall planning ability, and to ensure that no loose ends are left unattended. This is the preparation of an annual progress report which will do two things.

* Compare the progress of the company against the long-range plan to date.
* Compare performance over the past year, analysing variances and drawing conclusions that will lead to better planning.

This report should be prepared by the planner for the chief executive, but should be in such a form that it can be circulated to all senior managers. The very first of these reports will be able to say very little about progress towards the long-range targets, but this particular part of the report will become more valuable as the years go by and it becomes possible to plot on a graph actual performance against plan over a long time period.

The section of the report dealing with the annual plan must not deal with

the budget, as such, although it will not ignore major variances from the goals for that year. The sort of lessons which can be drawn deal with errors of omission, failure to fully consider assumptions, over-estimation by a manager of his capacity to undertake new tasks, and whether the variances fall within the risk tolerances originally calculated.

Perhaps the most important decision which the report must lead to is whether variances in the past year's performance justify a change in either the basic strategies of the long-range plan, or the results that can be expected from these strategies. This is not an easy matter. A variance, favourable or unfavourable, may occur in any one year's results because of purely short-term measures. Alternatively, it may indicate a trend to a serious departure from the long-term plan. Obviously it is of paramount importance for the company to try to understand which of the two possibilities apply. A wrong decision can either leave the company drifting towards another year of variance, or it can lead to a change in strategy which is unnecessary, and possibly undesirable.

The effect on managers of a bad year is also important. Unless the real reasons are known and accepted by those contributing to plans, there will be a tendency for pessimism to creep in when the next long-range plan is prepared. So the planner's annual analysis and report can do much to ensure that the plans of the following years are eventually converted to action.

The application of all these measures will ensure that long-range planning does not become an empty exercise. Not only do they ensure that the 5-, 10- or 15-year plan becomes converted into a series of meaningful tactical units which are capable of implementation, but they also continually measure progress towards implementation, causing necessary changes to be made which means that the plan always remains a living document. Beyond this, the measures underline the duties of individual managers, in a way which motivates them to fulfil their commitments. It is, after all, the actions of individuals which in the final event decide whether a plan is implemented, and unless the individual parts are made clear there may be grave difficulties in the way of achieving the whole.

While it may be possible to dispense with one or two of the measures, and still retain a fair chance of success, the company which adopts them all will be virtually certain to bridge the gap between planning and action, and no one can doubt the need to do this.

CHAPTER 15

COMPLETING THE CYCLE

At the close of Chapter 1, I suggested that there was a need to keep the whole corporate planning process in mind, as we focused attention on each of the separate parts.

Inevitably, discussion of the individual and specific aspects of corporate planning must have taken away some of this emphasis on the totality of the planned approach to management. Some chapters are longer than others, simply because the subject matter they contain took longer to explain. Unless corrected, the reader may excusably assume that length equates to relative importance, and that more attention should be given to the elements described in the longest chapters, than to those which appear in the shortest ones.

The purpose of this chapter is to ensure that these impressions are corrected so that the book finishes where it began, completing as it were a cycle of its own which is symbolic of the circular nature of so much of corporate planning.

It is also important to stress that the book has been written within a certain defined framework, and there is much that is relevant to the corporate planner which I have regarded as being outside of its scope. This is particularly true of the various techniques which are vital tools of the planners' trade—those which I have included have been given but scanty treatment, while others have not been discussed at all. My task has been to demonstrate corporate planning as a practical and useful way of management, to ensure that basic principles and methodology are presented in an understandable way. I hope this book will, in effect, present the managing director or planner with his driving licence: most of the techniques are for the advanced driver, and are not in themselves *essential* to effective progress along the road to the future (although they may be very useful).

There is the danger that explanation has over-simplified what is really

involved in corporate planning. I do not regard any aspect of planning as "difficult", in the sense of being hard to understand or perceive in relation to the needs of the individual firm. But every aspect may be "difficult" in the sense that each business is made up of a collection of individual people who will react to any changes made to the way in which they carry out their daily tasks. There may be very real problems of misunderstanding, conflicts of attitudes, uncertainty, or even the typically human reaction that anything different must be suspect—a reaction which comes to all of us from time to time. And most planning disappointments arise because of a failure to give adequate attention to the human element.

Every chief executive contemplating this method of running his company must face up to these difficulties. This means that he, above anyone in the company, must fully understand what is meant by corporate (or long-range) planning. Only those who do understand, and are sure that they want it, should introduce it to their organisations. The potential rewards are great, but they are available only to the companies which approach the problem in the right sort of way. Perhaps my overriding message to any chief executive is, if he is not sure, he should not do it.

Successfully introduced, planning will ensure that a company obtains a greater degree of control over its future than would otherwise be possible. These benefits will not come overnight, and are rewards only for the company that really works for them. The object is to stimulate, not to replace, the entrepreneurial processes: to make people think, not to substitute a set of procedures for creative effort.

Because of the difficulty mentioned earlier, it may take many months to make planning fully effective in a company. The time taken will vary from business to business, with the complexity of operations and with the natures of the managers who constitute the company. The chief executive must be prepared to allow his planner to take the introductory stages slowly. At the same time he should retain control over what is happening—it is a good idea for him to insist on a planners' plan of how the task is to be approached—perhaps a network diagram or bar chart. This controlled progress is a long way from the almost random development achieved by some new corporate planners. I have met planners who have claimed to have done virtually nothing for the first 6 to 12 months of their appointment, largely because they had little idea of what they should be doing!

I said earlier that no one can opt out of planning once a decision has been made to introduce it. I do not mean to imply that the introduction itself may

not be phased—perhaps started in one area this year, and another next. But again, the chief executive must ensure that he understands, and is in control of the "plan for the plan". Similarly, there is no reason why the chief executive of a subsidiary should not introduce corporate planning in advance of his head office.

Every corporate planning process is capable of improvement, and there are many new or recent developments in planning practice which are based on the use of computers which will enable the company to add to a sound basic system to make it an even keener-edged management tool.

Before moving into more advanced realms, the chief executive and the corporate planner must be convinced that the company is ready. No amount of clever frills will turn a company that plans badly into one that plans well. Indeed, the introduction of more advanced methods which lie beyond the capacity for understanding of the company's managers may well prove to be the last straw, the feather-touch which is enough to bring an unsteady edifice crashing to the ground.

So the timing of the use of new methods is a matter of keen judgement. It may be several years before a company is ready for all of them, although the speed is a matter which is individual to each company, and some companies may never be ready for them at all. On top of this, there is always a cost/benefit consideration. In some types of organisation computers may add little to the company's ability to plan, and the expense may exceed the rewards. In no case can a computer convert inputs of garbage into outputs of pearls of wisdom.

Perhaps the first area to consider for computer applications is in the realms of project appraisal. There are well-developed systems for discounted cash-flow appraisal, and for risk analysis. In fact, as mentioned elsewhere, some types of risk analysis are completely impracticable without computer assistance.

Computer possibilities become more exciting when related to the use of assumptions and the analysis of risk in long-range plans. In Chapter 5, the concept of quantifying and attaching probabilities to risk resulting from incorrect assumptions was explored in some depth. The reader was left to apply judgement in order to reduce the probable effects of a multiplicity of deviations to one overall figure—that essential figure that gives the chief executive a probability of being within defined limits of his primary objective, the profit target. Judgement is really inadequate for what may be a mammoth task, and some form of more advanced analysis becomes desirable

at an early date. The computer can handle this, using methods similar to those described earlier for the risk analysis of capital projects. Improved handling of data in this area can lead to a higher margin of confidence when considering plans to achieve long-range profit targets.

The use of mathematical models for forecasting is well known, and is not restricted to the company which practises the planned approach. Models have been developed to provide predictions of the future of the economy, although their use—and indeed their very development—has been generally confined to universities and similar institutions. Some companies have developed simulation models of particular markets, and use these to examine the effects of changes in marketing strategy.

From these applications it is a small conceptual step to something which I believe most planners would long to possess, as many now do, a complex model of the total company, which will enable the speedy evaluation of alternative strategies under different assumptions. The fast-response estimate of results for each possible alternative is definitely the most exciting planning aid to be developed in recent years. The ability which it gives a company to look at a wider range of possibilities, and the fact that it enables rapid updating of plans in the event of changes of strategy, mean that this is a tool which can cut out much of the tedious routine of planning, and vastly increase the scope of the company's top management.

Again, it is worth stressing that even the most exciting computer applications will not replace the basic processes of corporate planning which have been explained in this book. The advanced model of the company which the computer makes possible is only a logical extension of the simple manually calculated "models" described elsewhere in the book.

One aspect of which the chief executive should be aware is that the successful introduction of long-range planning will, in many companies, call for changes in the management information system. There may be a wide gulf between information generated for day-to-day control and that required for strategic planning. In addition, the internal information generated from the accountants needs to be co-ordinated with data from outside the company. In principle, there should be no difficulty, because corporate planning does not *create* a need for information: it merely forces attention to areas on which the company should have full information in any case. Unfortunately theory and practice do not always coincide, and I know that some planners have found it impossible to come to terms with the accounts function. Support for this belief is given in the American survey quoted above, which revealed many

areas of difficulty in motivating accountants to think as managers. I must add that, in my own personal experience, I have not found this a particular problem.

I do not believe that "anyone can do anything". I *do* believe that most people are capable of achieving results which are at a higher level than their current performance. Man has always reacted to a challenge, and frequently responds to the difficult task. If standards are set low, performance may fall to meet them. If an individual will rise to the excitement and stimulation of a challenging situation, how much more must this be true of a company. Every company is little more than a collection of people, organised to a common purpose.

When the challenge is put over in the correct manner, the whole company will respond, bringing results that may hitherto have been considered impossible. The ultimate in efficiency, in innovation, in profit-earning skills, is never reached. The day any manager believes that he is running his operation so well that no improvement is possible is the day he should resign. The task of every manager is to stretch towards a state of perfection—but never to believe he has reached it. This is how people do "impossible" things, how companies achieve "impossible" results.

I believe that corporate planning releases energies in a company which enable it to achieve the "impossible". This is not a backs-against-the-wall fight-to-the-last-man type of motivation, but one which is flexible enough to take account of human needs and social values. There are differences between companies. We all know the situations in some firms where anything new or different is perceived as a threat. And we all know those other companies, where morale is high, where managers make their own miracles, and where it seems that nothing is considered to be beyond the powers of the company.

If a chief executive believes in the planned approach, and is willing to introduce it in a competent and professional manner, he can release these energies which will change his organisation's conception of what it can achieve.

This, in a nutshell, is the reward for corporate planning—and the substance of the reward far exceeds the cost. I believe that, in the modern world, there are few companies which can afford to ignore the future, or to allow this benefit to slip through their fingers, and there is no reason why any chief executive should not gain the advantages of the planned approach. It lies within his power to do something about it.

READING LIST

There are many books which are of value to the manager interested in corporate planning (although not all of them are about planning as such). New publications appear regularly, and there have been considerable developments in corporate planning since the first books appeared in the 1960s.

If I had to recommend three particular books which would help the reader to explore the issues of corporate planning in greater depth I would choose:

G. Steiner (1969): *Top Management Planning*, MacMillan, New York.

D. E. Hussey (1974): *Corporate Planning: Theory and Practice.* Pergamon, Oxford.

H. K. Warren (1966): *Long Range Planning: The Executive Viewpoint.* Prentice Hall.

The first two books are comprehensive, and cover virtually every aspect of corporate planning. In addition they both include substantial bibliographies: Steiner lists U.S. publications and Hussey lists European (mainly U.K.).

Warren's book is very different. It is research based, and is one of the earliest research contributions to planning. It provides a very good analysis of the things to avoid when introducing planning.

The following list is designed to give a select guide to other books and articles of relevance to the various issues discussed in this book.

1. *Environmental Factors*

D. E. Hussey (1976): *Inflation and Business Policy*, Longmans.

D. E. Hussey (Ed.) (1978): *The Corporate Planners' Yearbook, 1977-1978*, Pergamon (includes a directory of economic forecasting services).

B. W. Scott (1962): *Long Range Planning in American Industry*, American Management Association (contains a very good chapter on setting assumptions).

2. *Forecasting*

J. C. Chambers, K. M. Satinedes and D. D. Smith (1971): How to choose the right forecasting technique. *Harvard Business Review*, July-Aug.

G. Wills *et al.* (1972): *Technological Forecasting*, Pelican.

E. Jantsch (1968): Technological forecasting in corporate planning. *Long Range Planning*, Sept. 1968.

D. E. Hussey (Ed.) (1978): *Corporate Planners' Yearbook* (*op. cit.*) (contains chapters on economic forecasting).

3. *Corporate Appraisal*

B. W. Denning (1971): *Corporate Planning: Selected Concepts*, McGraw Hill (introductory chapter).

P. Drucker (1964): *Managing For Results*, Heinemann.

4. *Case Studies and Research*

R. Young and D. E. Hussey (1977): Corporate planning at Rolls Royce Motors, *Long Range Planning*, April 1977.

P. Baynes (Ed.) (1973): *Case Studies in Corporate Planning*, Pitman.

G. A. Steiner (Ed.) (1963): *Managerial Long Range Planning*, McGraw Hill.

G. A. Steiner (1972): *Pitfalls in Comprehensive Long Range Planning*, Planning Executives Institute.

K. A. Ringbakk (1968): Organised planning in major U.S. companies. *Long Range Planning*, December.

B. Taylor and P. Irving (1971): Organised planning in major U.K. companies. *Long Range Planning*, June.

5. *Corporate Strategy*

T. Levitt (1962): *Innovation in Marketing*, McGraw Hill (available in Pan edition).

H. I. Ansoff (1965): *Corporate Strategy*, McGraw Hill (available in Pelican edition).

P. Drucker (1964): *Managing for Results*, Heinemann (available in Pan edition).

E. J. McCarthy (1964): *Basic Marketing: A Managerial Approach*, Irwin.

R. C. Ackoff (1970): *A Concept of Corporate Planning*, Wiley Interscience.

J. Hitching (1967): Why do mergers miscarry? *Harvard Business Review*, Nov./Dec.

D. E. Hussey (1976): Strategic planning and inflation. *Long Range Planning*, April.

6. *Manpower Planning*

M. G. McBeath (1966): *Organisation and Manpower Planning*, Business Books.

J. L. Lynch (1968): *Making Manpower Effective*, Pan.

J. Bramham (1975): *Practical Manpower Planning*, Institute of Personnel Management.

R. L. Desatnick and M. L. Bennett (1977): *Human Resource Management in the Multinational Company*, Gower.

7. *Planning Techniques*

A. J. Merritt and A. Sykes (1963): *The Finance and Analysis of Capital Projects*.

J. F. Magee (1964): Decision trees for decision making. *Harvard Business Review*, July-Aug.

J. F. Magee (1964): How to use decision trees in capital investment. *Harvard Business Review*, Sept.-Oct.

A. J. A. Argenti (1969): *Management Techniques: A Practical Guide*, Allen & Unwin.

J. B. Boulden (1971): Computerised corporate planning. *Long Range Planning*, June.

P. G. Moore (1978): *Basic Operational Research*, Pitman.

A. Battersby (1966): *Mathematics in Management*, Pelican.

M. J. Khami (1968): Gap analysis: key to super growth. *Long Range Planning*, June.

R. N. Kashyan (1972): Management information systems for corporate planning and control. *Long Range Planning*,

The journal *Long Range Planning*, the official journal of the Society for Long Range Planning, is the leading international source for regular articles in planning topics. It publishes case studies, research findings and numerous articles on all aspects of planning.

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